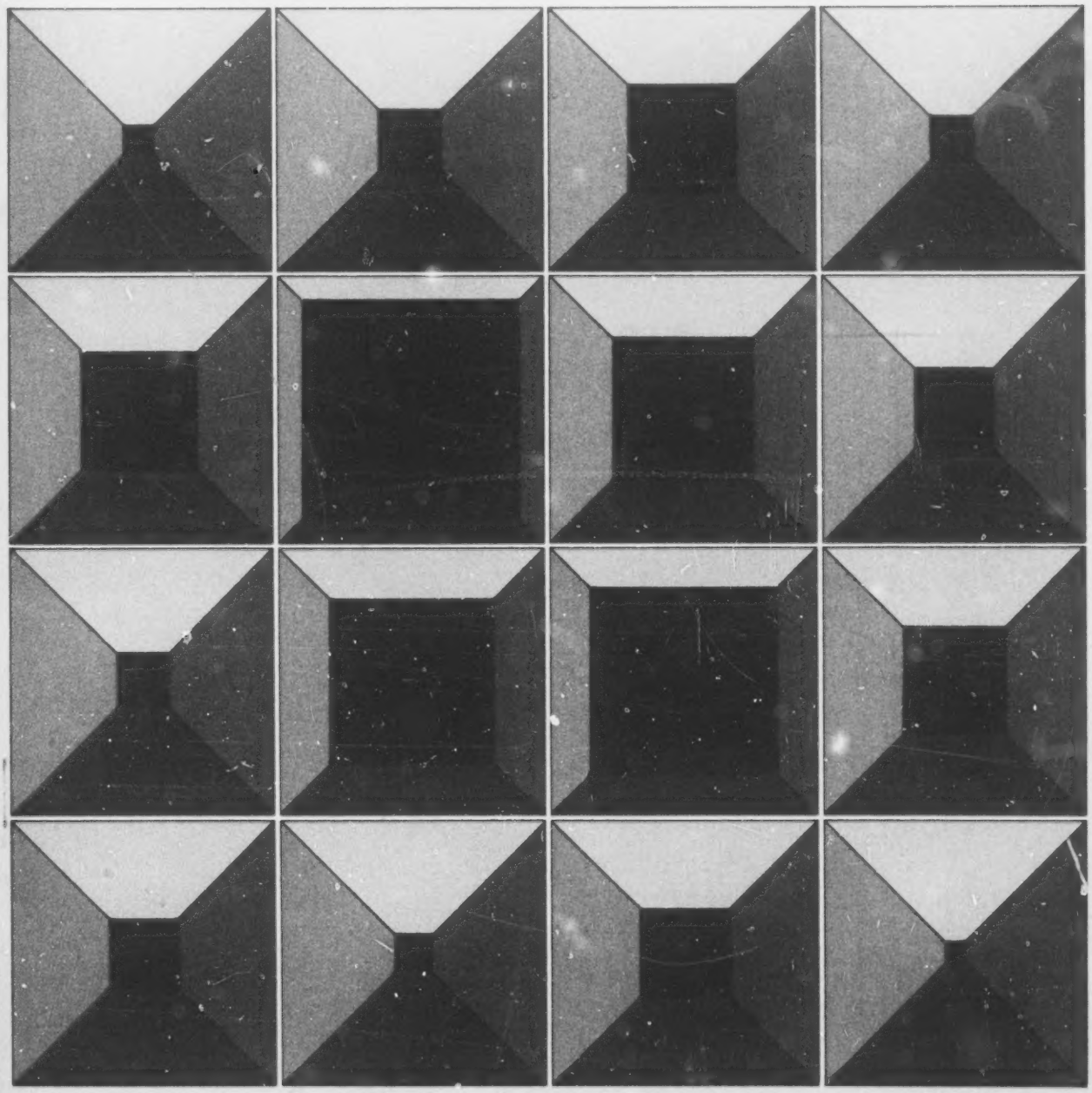
A CBO STUDY

Balancing the Federal Budget and Limiting Federal Spending: Constitutional and Statutory Approaches

September 1982

Congress of the United States
Congressional Budget Office



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BALANCING THE FEDERAL BUDGET AND LIMITING FEDERAL SPENDING: CONSTITUTIONAL AND STATUTORY APPROACHES

The Congress of the United States
Congressional Budget Office

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PREFACE

The Congress is considering over a hundred proposals that would limit the growth of federal spending or revenues, prohibit federal budget deficits, or both. Some of the proposals are in the form of amendments to the U.S. Constitution while others are in the form of legislation. One of these, S.J. Res. 58, has already passed the U.S. Senate. All of the proposals presume that the current budgetary procedures are incapable of overcoming a perceived bias in favor of ever greater levels of federal expenditures and persistent deficits.

This study, prepared at the request of the Senate Committee on the Budget and the House Committee on the Judiciary, analyzes the present system and the alternatives before the Congress. The study examines the degree to which the current procedures have produced ever higher levels of expenditures and persistent deficits, describes the rationales of the present system and the proposed alternatives, analyzes the effects of the alternatives on the economy and the size of the federal sector, and sets out some of the major difficulties that might be encountered in implementing the alternatives. In keeping with the mandate of the Congressional Budget Office (CBO) to provide objective analysis, the report contains no recommendations.

The paper was written primarily by John W. Ellwood. Alfred B. Fitt wrote Chapter I; Robert W. Hartman wrote the section on "The Short-Run Effects" in Chapter V; and Marvin M. Phaup, Jr., wrote the section on "The Long-Run Effects" in Chapter V. The authors wish to thank James Annable, William Beeman, James Blum, James Capra, Martin Levine, John Shillingburg, Paul Van de Water, and James Verdier of CBO for their comments. In addition, many persons outside CBO provided valuable advice and criticisms, including Mickey Levy, William A. Niskanen, Donald G. Oglivie, Allen Schick, and Aaron Wildavsky.

Patricia H. Johnston edited the manuscript. Nancy H. Brooks typed the paper and prepared it for publication; Norma Leake typed several early drafts.

Alice M. Rivlin
Director

September 1982

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S.J. RES. 58
AMENDMENT TO THE CONSTITUTION
As proposed by the U.S. Senate on
August 4, 1982

Article --

SECTION 1. Prior to each fiscal year, the Congress shall adopt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts. The Congress may amend such statement provided revised outlays are no greater than revised receipts. Whenever three-fifths of the whole number of both Houses shall deem it necessary, Congress in such statement may provide for a specific excess of outlays over receipts by a vote directed solely to that subject. The Congress and the President shall, pursuant to legislation or through exercise of their powers under the first and second articles, ensure that actual outlays do not exceed the outlays set forth in such statement.

SECTION 2. Total receipts for any fiscal year set forth in the statement adopted pursuant to this article shall not increase by a rate greater than the rate of increase in national income in the year or years ending not less than six months nor more than twelve months before such fiscal year, unless a majority of the whole number of both Houses of Congress shall have passed a bill directed solely to approving specific additional receipts and such bill has become law.

SECTION 3. The Congress may waive the provisions of this article for any fiscal year in which a declaration of war is in effect.

SECTION 4. Total receipts shall include all receipts of the United States except those derived from borrowing and total outlays shall include all outlays of the United States except those for repayment of debt principal.

SECTION 5. The Congress shall enforce and implement this article by appropriate legislation.

SECTION 6. On and after the date this article takes effect, the amount of Federal public debt limit as of such date shall become permanent and there shall be no increase in such amount unless three-fifths of the whole number of both Houses of Congress shall have passed a bill approving such increase and such bill has become law.

SECTION 7. This article shall take effect for the second fiscal year beginning after its ratification.

CHAPTER I. INTRODUCTION AND OVERVIEW

Persistent federal deficits, coupled with steady growth in the share of the economy devoted to federal spending, have caused concern in many quarters. This concern led 31 state legislatures to petition the Congress to take some kind of action that would result in a Constitutional amendment favoring balanced budgets. More than 100 measures have been introduced in the 97th Congress proposing either statutory or Constitutional changes aimed at making deficits less likely and spending and taxing restraint more likely. President Reagan has endorsed and the Senate of the United States has now passed a resolution proposing a specific Constitutional amendment on the subject.

This report begins with an overview of the Senate proposed amendment and the mid-1980s budget context in which it might take effect. Chapter I concludes with a description of the organization of the balance of the report.

OVERVIEW

When introduced in 1981, Senate Joint Resolution 58 and House Joint Resolution 350 were identical proposals for amending the Constitution to prescribe certain Congressional budget-making rules. The Senate, on August 4, 1982, by a 69-31 margin approved an altered version of S.J. Res. 58, while the House Committee on the Judiciary still is considering H.J. Res. 350. This overview will describe only S.J. Res. 58, because it remains to be seen whether or in what form the House will take up the question.

Provisions of S.J. Res. 58

The proposed amendment is designed to accomplish two purposes: to encourage the adoption of balanced instead of deficit budgets, and to limit the size of the federal government as a proportion of the total economy.

Balancing the Budget. S.J. Res. 58 directs the Congress, before the start of each fiscal year, to "adopt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts."

If the amendment is ratified, the Constitution thereafter would consider balanced budgets to be the normal rule. Departures from that rule would be permitted, however, since the "statement of receipts and outlays"--that is, the budget of the United States government--may project outlays greater than receipts if three-fifths of the whole membership in both bodies approve.

Limiting the Size of Government. The proposal prohibits projecting receipts to rise at "a rate greater than the rate of increase in the national income," unless an absolute majority in both bodies has passed a bill "approving specific additional receipts and such bill has become law."

Because the normal rule set forth by S.J. Res. 58 is that outlays will not exceed receipts, and because receipts may not grow more rapidly than national income, the effect is to place an upper bound on federal spending as a proportion of national income. However much or little the national income grew in the base period (which the amendment leaves for later Congressional definition) will determine however much or little federal spending can be projected to grow in the budget year, irrespective of the assumed performance of the economy in that budget year.

The short-run effect of this formulation is to discourage balancing the budget by raising taxes instead of cutting spending. The long-run effect is to prevent growth of the federal government in relation to the private sector, unless Congressional majorities specifically vote otherwise.

This portion of the amendment is apparently mainly aimed at the "unlegislated" tax increases resulting from the effect of inflation on a progressive income tax system: taxpayers whose real incomes are not increasing are nevertheless pushed into higher income tax brackets and therefore pay a larger share of their incomes to the federal Treasury ("bracket creep"). If the Congress must vote the increase instead of simply letting it happen, an increase is less likely. (Another approach, but one with the same effect and already adopted by the Congress for 1985 and future years, is to index income tax brackets and exemptions to inflation in ways that will minimize bracket creep.)

Enforcement. The proposed amendment is not self-enforcing. No penalty is prescribed if the Congress is unable or chooses not to adopt a budget. In those circumstances, the "budget" would be the sum of appropriation and revenue bills that became law for that year, whether a surplus, a balance, or a deficit.

Section 5 of the proposal commands the Congress to "enforce and implement this article by appropriate legislation," however. The command is very clear, but in the end the response must be shaped by the Congress; it would not be found in the Constitution.

Assuming that the Congress does adopt "a statement of receipts and outlays," then the proposed amendment directs both the Congress and the President to "ensure that actual outlays do not exceed the outlays set forth in such statement." The precise means for ensuring such an outcome are left for later legislative prescription or, in the case of the President, through the exercise of whatever Constitutional powers he already possesses.

Actual revenues, on the other hand, need not agree with the receipts projected in the budget; they may be either more or less. Thus, while the amendment does not tolerate an excess of actual outlays over planned outlays (even if the budget still remains in balance), it accepts a level of actual revenues short of planned receipts (even if this results in a deficit).

The reason for more lenient treatment of revenue shortfalls than outlay overruns was that the drafters of the amendment wished to allow for a short, unexpected recession, and its consequent revenue loss, without necessitating immediate compensating tax increases or spending cuts that might worsen the recession. However, a section added on the Senate floor erects the barrier of a supermajority vote against unplanned as well as planned deficits.

The Armstrong-Boren Amendment. During debate on S.J. Res. 58, Senators Armstrong and Boren successfully cosponsored what is now Section 6 of the proposed amendment. The section prohibits any increase in the statutory public debt ceiling on the date the amendment takes effect, unless three-fifths of the whole membership of both bodies thereafter approves a bill for that purpose and the bill becomes law.

The effect of Section 6 is to impose a real sanction against evading the strictures of the proposed amendment by simply failing to adopt any budget at all. But Section 6 would also bar unplanned deficits resulting from revenue shortfalls, unless there was leeway within the statutory debt ceiling. (This is true under present law as well, but simple majorities in the Congress, with the concurrence of the President, can raise the debt ceiling as necessary, whereas under Section 6, just 41 percent in either body could prevent a solution.)

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Waiver and the President. All the provisions of the proposed amendment may, but need not, be waived by simple majorities in the Congress for any fiscal year in which a declaration of war is in effect.

The President has no formal role either in the declaration of a war or in the waiver permitted by the amendment. Similarly, he has no formal role in the process by which Congress would adopt or amend "a statement of receipts and outlays" under S.J. Res. 58, whether in balance or in deficit. But he would have a role if the Congress wished to project receipts greater than permitted by the amendment's formula, for that would require a bill to be presented for his approval.

Effective Date. The amendment provides that it "shall take effect for the second fiscal year beginning after its ratification." For example, if the necessary number of states were to ratify the amendment before October 1, 1983, it would apply to fiscal year 1985, and the first "statement of receipts and outlays" would have to be in place by September 30, 1984, that is, sometime during the first fiscal year beginning after ratification.

The Purposes of S.J. Res. 58: Are They Desirable?

The First Goal: Balancing the Budget. The federal budget has been in deficit for 13 straight years and 21 of the last 22 years. The Congress has already approved deficits for the next three years. CBO now projects those deficits to exceed $150 billion in each year, and to be about $170 billion when off-budget spending is counted. The CBO projection assumes that all of the savings contemplated by the budget resolution for fiscal year 1983 will be achieved; if they are not, the outlook is even bleaker.

By five-year periods beginning in fiscal year 1962 and ending with fiscal year 1981, the annual deficit has averaged 0.8, 1.2, 2.1, and 2.0 percent of gross national product (GNP), and in no year did it exceed 4.0 percent of GNP. CBO projects that it will average 4.1 percent of GNP during fiscal years 1982-1985, however, with a peak of 4.7 percent in 1983.

Such persistent and large deficits portend continued difficulties in lowering interest rates and encouraging economic growth. Additionally, when the economy is operating close to capacity, a deficit contributes to inflationary pressures. More-

over, service of a growing national debt is preempting an ever larger share of the budget. Net interest on the federal debt has risen from 6.4 percent of budget outlays in fiscal year 1962 to nearly 10.5 percent in 1981, and may reach 13 percent by fiscal year 1985.

While concern over the implications of chronic deficits for long-run growth and for inflation is warranted, a federal deficit can be an important instrument for countering a recession. A deficit can help moderate income losses during a recession, thereby lowering the risk of a deeper decline in the economy. Moreover, in a prolonged or severe downturn, planned deficits--from a tax cut or temporary expenditure rise--can help to reverse the economic slide. A budget forced to be in surplus or balance during a downswing in the business cycle would harm rather than help the faltering economy.

All in all, the first goal of S.J. Res. 58--balancing the budget--is meant to give much heavier weight to the objectives of economic and productivity growth, and to moderation of inflation. But in so doing, it reduces the ability of the government to counter downturns in the economy and thus creates risks that an unrestrained budget process could avoid. Even if one grants that greater concern with growth and inflation is appropriate, whether a Constitutional amendment is the right means to express this concern is another matter, discussed later in this chapter.

The Second Goal: Limiting the Size of Government. Measured by federal spending, the government has grown from about 18 percent of GNP in the late 1950s to 20 percent in the early 1970s, and to an estimated 24.1 percent in 1982. (The 1982 figure should not be overemphasized; it is more the consequence of an economy in recession than of a government on the rise.) The budget plan adopted by Congress for fiscal years 1983-1985 will gradually cut back outlays as a percent of GNP to an estimated 22.7 percent in 1985.

Whether the described trends are desirable or undesirable, too slow or too fast, enough or not enough, cannot be demonstrated by analysis; rather the answer is a matter for intuition and political judgment. Few people have an explicit view as to what percentage of the gross national product should be administered by the federal government. The American people do, however, want a strong defense, clean air, safe skies, security in old age, an efficient FBI, protection against floods, and so forth. They do not want a crumbling interstate highway system, rundown national

parks, rotten food in cans, failures in private pension plans, and so forth. The point at which the Congress and the President balance the people's infinitely numerous wants and aversions against their normal and natural reluctance to pay higher taxes will determine the size of the federal government.

If S.J. Res. 58 becomes part of the Constitution, it will represent a judgment that the size of the government at the time of ratification, measured by revenues as a proportion of national income, is about right.

New Budget Controls: Where Should They Appear?

If it is taken as a given that the Congressional budgeting process should be changed in ways that favor balanced over unbalanced budgets, there remains the question of whether to accomplish the change by rule, by statute, or by Constitutional amendment.

Proponents of change, short of a Constitutional amendment, argue that Congress has, and should use, the power to alter its own procedures in ways that strengthen the general interest in legislative combat with the special interests that press so hard for spending growth.

Those who hold this view maintain that Congress has in recent years shown greater recognition of the problem, and a willingness to deal with it, first with the enactment of the Congressional Budget Act of 1974, and since then with a variety of devices consistent with (though not originally contemplated by) that act, all of which tend to hold down spending or force committees to stay within the budget plan adopted by the full Congress.

There are, of course, many procedural changes that would favor balanced over unbalanced budgets. For example, either body could adopt a rule requiring a three-fifths majority to approve a budget deficit. But this change, as well as any other accomplished by amending legislative rules, has a major flaw in the view of supporters of a Constitutional amendment: the Congress can always decide to waive its own rules, and the next Congress can always reject the procedures of its predecessor. The same argument applies against reform by statute instead of by rule. Skeptics can and do point to the Byrd Amendment of 1978 (reaffirmed in 1980 and yet again in 1982), which provided that "Beginning with Fiscal Year 1981, the total budget outlays of the Federal Government shall not exceed its receipts," as an example of the futility of any Congressional commitment to a balanced budget.

Advocates of trying additional Congressional reform before turning to a Constitutional amendment argue, in turn, that the Byrd Amendment teaches only that declarations are not enough to change institutional behavior; it does not teach that actual procedural changes will be futile.

They also urge that flexibility in changing or waiving procedural rules from time to time is a virtue, not a vice, given the frequency of unanticipated events in the world, and that the Constitution, so difficult to amend, is particularly the wrong place to prescribe what shall be the normal fiscal policy of the United States.

Supporters of the Constitutional amendment route argue that Congress has consistently and convincingly demonstrated an institutional inability to defend the general interest against the hosts of special interests. The result--and they point to history as proof--is that spending proposals gain broad support, but that proposals to pay for the spending have no clear constituency and hence weak support at best. According to this argument, the case is already made: the Congress cannot and will not discipline itself, and budget deficits will forever be the norm unless a higher power--the Constitution--is brought to bear on the problem.

Ultimately, the issue comes back to the will of Congress. If a majority favors the kinds of change contemplated by S.J. Res. 58, then that change will occur, and can be accomplished without a Constitutional amendment. If S.J. Res. 58 should become a part of the Constitution, but not command majority support in some future Congress, it must be expected that the actual majority will search for and may well find a way to work its will.

Transition Problems

With projected on-budget deficits of over $150 billion in each of the next three fiscal years, balancing the budget in that period does not seem like a realistic objective. Indeed, a reduction in the deficit of sufficient size to balance the budget as early as 1985 would mean a reduction in fiscal stimulus that would not be consistent with continued economic recovery, unless an improbably easier monetary policy were adopted. It is desirable, however, to work in the direction of budgetary balance along the lines contemplated by the budget resolution for 1983. But the task, however desirable, will present formidable difficulties to the Congress.

To illustrate, CBO projects that outlays for 1985 under the current Congressional budget plan will be $910 billion. National defense, pensions, Medicare, other entitlements and net interest will consume $807 billion. All the rest of government--education, highways, law enforcement, welfare, grants to states, disease control and so on--consumes the remainder. If there is to be any significant reduction in the $152 billion deficit projected for that year, some combination of tax increases and cuts in all parts of the budget will be necessary.

If S.J. Res. 58 should be part of the Constitution by 1985, it follows that at least for several more years the Congress may well have to muster three-fifths votes for an unbalanced budget.

PLAN OF THIS PAPER

The next chapter begins with a review of the two perceived problems of deficits and high levels of federal spending. It then examines the degree to which the federal budget has been unbalanced in recent years; how fast federal expenditures have grown; what types of spending have driven that growth; whether the public's desires have been reflected in recent federal budgetary policy; and why the movement to change the Congressional budget process so fundamentally has gained such momentum at this time.

Chapters III and IV set out the various procedural changes that have been proposed to end federal budget deficits and limit the growth of expenditures. The options are not limited to rules and prohibitions; the discussion includes ways to improve the present process incrementally by providing more and better budgetary information to increase the government's accountability.

Chapters V and VI examine effects on the economy and the level of federal spending if either a prohibition on budget deficits or a limit on expenditures was successfully achieved. There is great disagreement over whether and under what conditions this is possible. Chapter VII, therefore, analyzes the workability of the various budget reform proposals.

CHAPTER II. THE HISTORICAL RECORD

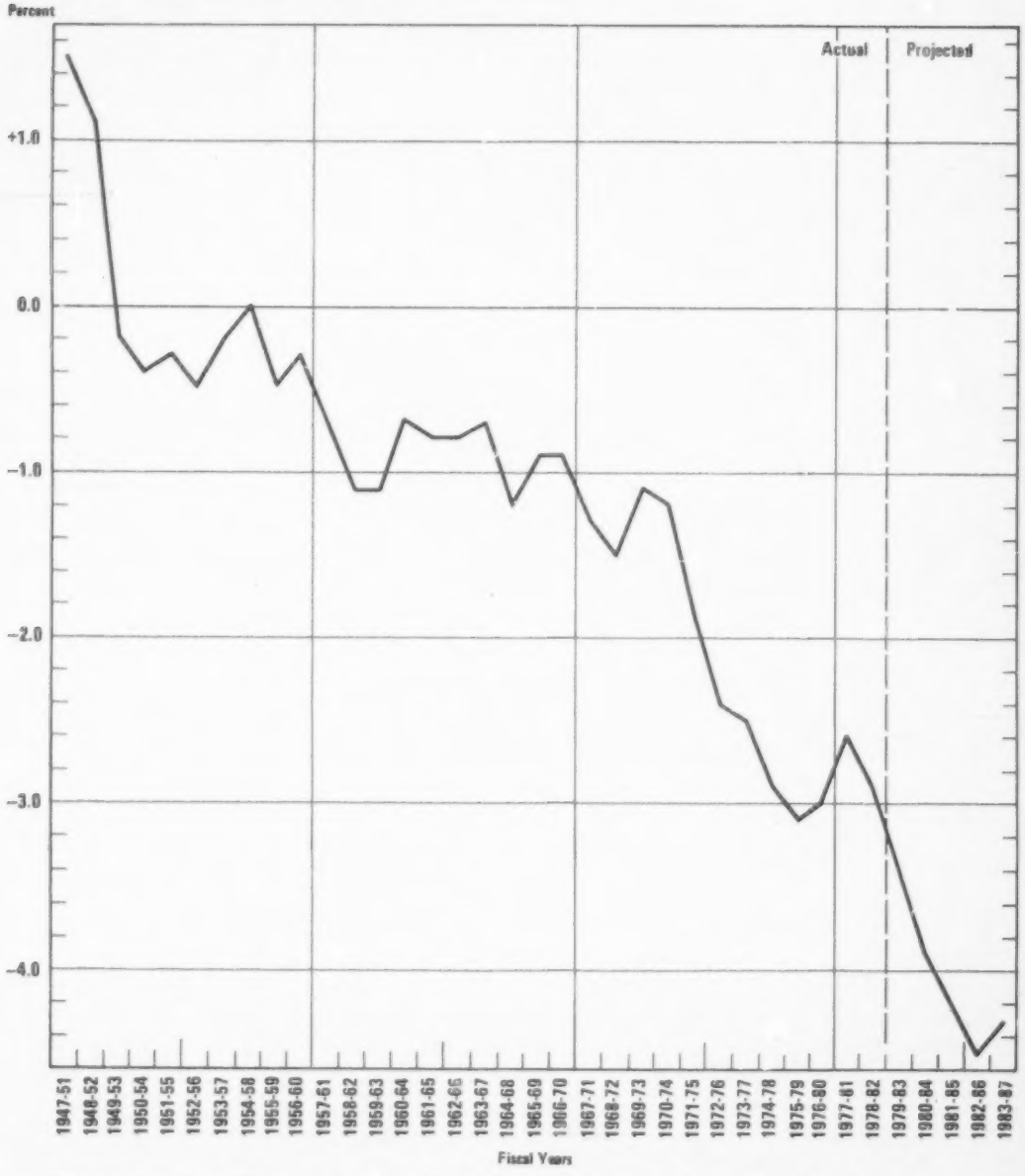
This chapter presents background data on the frequency and magnitude of federal budget deficits and the rate and sources of federal expenditure growth. U.S. budget data support the contention that federal deficits have been growing in number and size and that the federal sector has increased steadily, if moderately, over the past 20 years.

But cross-national data do not establish a connection between a pattern of deficits and expenditure growth and a country's economic performance. In fact, over the past decade, only France and Canada of the major industrial countries had smaller deficits than the United States. Similarly, only Japan had a smaller public sector and none of the industrialized countries had public sectors that grew as slowly as that of the United States. Thus, while several countries have had greater success than the United States in maintaining lower inflation and higher productivity and economic growth, their better economic records do not appear to be based on their deficits (or lack thereof) or the size of their public sectors.

THE UNBALANCED BUDGET

In fiscal year 1982, after the enactment of the largest budget reduction in American history, the federal budget still will be in deficit for the 13th straight year, the 19th time in the last 20 years, the 42nd time in 50 years. Moreover, unified budget deficits have grown in recent years; of the $486 billion in deficit piled up in the last 20 years, three-quarters ($363 billion) has been accumulated since 1974. Even as a percent of the gross national product (GNP), deficits have been growing in recent years (see five-year moving averages of deficits as a percent of GNP in Figure 1). From fiscal year 1946 through 1960, federal expenditures exceeded revenues by an average of 0.4 percent of the GNP. But, over the next decade, the federal budget averaged a deficit equivalent to 0.8 percent of the GNP; and, over the last 11 years, the average magnitude of the deficit has increased to 2.4 percent of the GNP. And, if current policies are continued, the nation faces federal deficits in the 3 to 4 percent range of GNP over the next five years.

Figure 1.
Five-year Moving Average of the Total Budget Surplus (+) or Deficit (−) as a Percent of GNP[a]



[a] Total budget surplus or deficit equals the unified budget surplus or deficit plus the deficit from off-budget programs.

TABLE 1. CENTRAL GOVERNMENT NET BORROWING (SURPLUSES = +; DEFICITS = -) ON A SYSTEM OF NATIONAL ACCOUNTS (SNA) BASIS a/ AS A PERCENT OF GDP/GNP b/

Country	1974	1975	1976	1977	1978	1979	Average 1974-1979
United States c/	-0.8	-3.5	-2.2	-1.6	-1.3	-0.5	-1.7
Germany c/	-0.5	-3.0	-2.3	-1.5	-2.1	-1.8	-1.9
France d/	+0.9	-1.9	0.0	-0.9	-1.3	-1.3	-0.8
United Kingdom d/	-1.0	-3.4	-4.1	-2.9	-3.7	-3.7	-3.1
Italy d/	-4.3	-8.0	-5.2	-5.1	-11.6	-11.6	-7.6
Canada c/	+0.7	-2.3	-1.7	-3.5	-4.9	-3.7	-2.6

SOURCE: Organization for Economic Corporation and Development (OECD), National Accounts of OECD Countries: 1960-1977, Volume II (Paris, 1979) and communications with OECD.

a/ The SNA, used by OECD and the United Nations, is an attempt to develop national accounts that can be used to compare countries with different budget concepts and varying definitions of the public sector.

b/ The gross domestic product (GDP) is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

c/ As a percent of GNP.

d/ As a percent of GDP.

The U.S. government is not unique in having run deficits since 1974. As indicated in Table 1, the central governments (equivalent to the U.S. federal government) of most industrial nations ran deficits after 1975 as their budgets reacted to the 1973-1975 recession--one of the most severe of the postwar era. The differences in the deficits and surpluses of various nations at various times, however, are not caused solely by different economic conditions; they also represent diverse spending and tax policies. In the case of the United States, for example, even when federal budget outlays and revenues are reestimated

under the assumption that the economy was operating at "high employment," the federal budget remains in deficit every fiscal year since 1970. 1/ These high (full) employment deficits resulted from policies aimed at reducing structural unemployment and achieving other goals, such as providing federal assistance for activities ranging from ensuring the national defense to rebuilding America's cities and compensating for the effects of inflation by periodically reducing taxes.

Focusing on central or national government budget balances can be a misleading way to compare the fiscal policies of nations, since the governmental structures of countries vary. The United States and Germany, for example, have federal systems in which many services are budgeted at state and local levels. Great Britain and France, on the other hand, have unitary structures in which the expenditures for most programs appear in their central governments' budgets.

The fiscal policies of various levels of government also vary among countries. While most of the U.S. state and local governments have legal or constitutional requirements that prohibit deficits in their operating budgets, this is not the case for some other nations. 2/ From 1970 through 1977, for example, while state and local governments in the United States averaged a surplus equal to 0.7 percent of GNP, the equivalent governments in Germany averaged a deficit equal to 1.3 percent of its GNP. 3/

1/ Frank de Leeuw and Thomas M. Holloway, "The High-Employment Budget: Revised Estimates and Automatic Inflation Effects," Survey of Current Business (April 1982), pp. 21-33.

2/ It should be noted, however, that most American state and local governments may borrow for capital expenditures. In addition, many states and localities have established various authorities that issue their own bonds. Most state and local debt, unlike federal debt, is in the form of long-term bonds and securities. In total, state and local debt has been increasing at a faster rate than federal debt; during the period 1959-1979, it grew at an average annual rate of 8.0 percent, while federal debt grew at an average rate of 5.3 percent per year. See Appendix A for a more detailed explanation.

3/ The measures of surplus and deficit used here is "net lending" within the OECD and United Nations' System of National

Figure 2 contains a thirteen-year comparison of the surplus/deficit positions of the general government sectors (made up of a country's national, state, and local governments) of the seven largest nations in the Organization for Economic Cooperation and Development (OECD). Using this measure, from fiscal years 1970 to 1982, the United States averaged smaller deficits in relation to the size of its economy than Germany, Great Britain, Italy, or Japan. It should be remembered, of course, that economic conditions, as well as budgetary policies, can vary by country.

During the 1970s, several industrial countries--most notably Germany and Japan--experienced much better real economic growth than the United States. Among the major industrial nations, Germany had much greater success in controlling its level of consumer price increases. The reasons for these variations are complex and open to dispute. Among the factors frequently mentioned are more restrictive monetary policy, greater productivity resulting from a willingness to shift expenditures toward investment rather than consumption, and a more favorable balance of trade.

Although under some circumstances deficits clearly affect economic performance, the degree of a country's success in achieving economic growth is not directly related to the existence or magnitude of its public sector deficits, as shown in Figure 3. During the 11-year period of 1970 to 1980, Japan and Italy had much higher rates of real economic growth while running deficits well in excess of those of the United States. France also achieved better economic performance than the United States, although it ran much smaller deficits in comparison to the size of its economy.

Figure 4 presents the same mixed picture for the association of deficits and increasing consumer prices. France's inflation rate was almost twice Germany's although its deficits in relation to the size of the economy were much smaller. The United Kingdom

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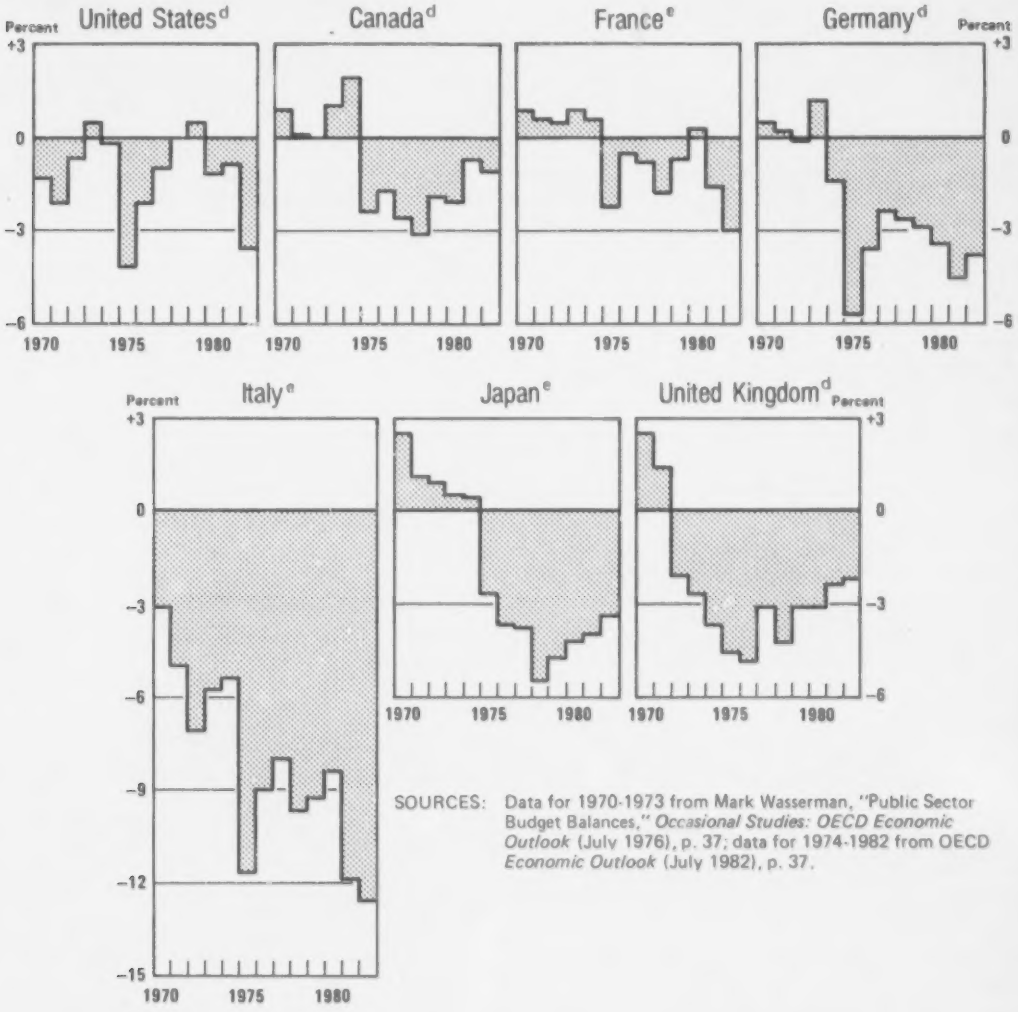
Accounts (SNA). This system is an attempt to develop national accounts that can be used to compare countries with different budget concepts and varying definitions of the public sector. See Mark Wasserman, "Public Sector Budget Balances," OECD Economic Outlook: Occasional Studies (Paris: OECD, 1976), pp. 37-51; and Raja Chelliah, "Significance of Alternative Concepts of Budget Deficits," IMF Staff Papers (Washington, D.C.: International Monetary Fund, November 1973).

Figure 2.

Selected General Government Net Borrowing (Surplus=(+); Deficit=(−)) as a Percent of GNP/GDP[a] on a System of National Accounts Basis,[b] 1970-1982[c]



SOURCES: Data for 1970-1973 from Mark Wasserman, "Public Sector Budget Balances," *Occasional Studies: OECD Economic Outlook* (July 1976), p. 37; data for 1974-1982 from OECD *Economic Outlook* (July 1982), p. 37.

[a] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

[b] This system is used by OECD and the United Nations. It is an attempt to develop national accounts that can be used to compare countries with different budget concepts and varying definitions of the public sector.

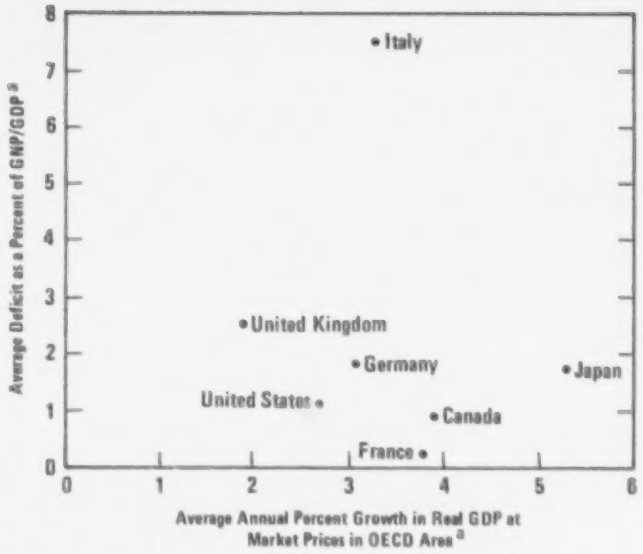
[c] Data for 1981 and 1982 are OECD estimates.

[d] Percent of GNP

[e] Percent of GDP

Figure 3.

Comparison of General Government Deficits and Real GDP Growth, 1970-1980

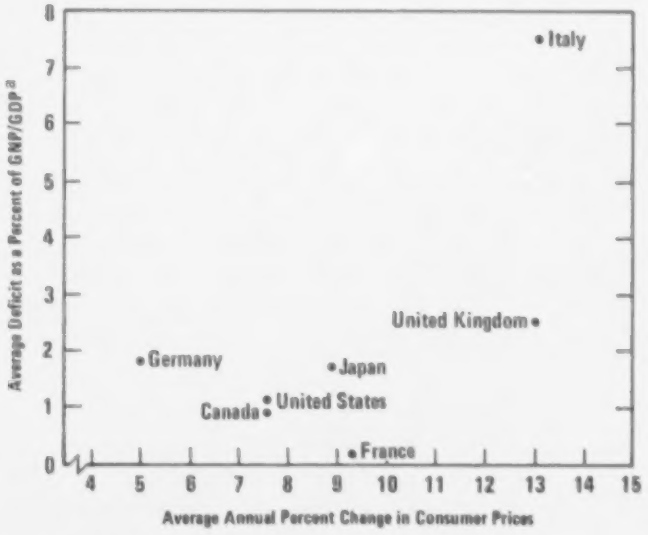


SOURCE:
OECD Economic Outlook,
Volume 31, July 1982.

[a] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

Figure 4.

Comparison of General Government Deficits and Consumer Price Inflation, 1970-1980



SOURCE:
OECD Economic Outlook,
Volume 31, July 1982.

[a] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

and Italy averaged about the same rate of increase in their consumer prices, although the United Kingdom averaged a deficit of 2.5 percent of its GNP while Italy's annual average was 7.5 percent of its economy.

THE SIZE OF GOVERNMENT AND THE GROWTH OF SPENDING

In addition to the rising unease about federal budget deficits, there is a widely voiced view that the federal government is too big. The contention of bigness cannot be confirmed by some measures. The number of civilian federal employees, for example, has steadily declined from 16 per thousand of population in 1952 to less than 13 per thousand in 1981. In 1981 there were 260,000 fewer people on the federal civilian payroll than there were in 1971. On the other hand, state and local government employment has grown by more than 3.2 million over the same ten-year period--a 31 percent increase--with much of this growth resulting from the additional employees needed to administer federally funded programs. In addition, the federal government increasingly has turned to quasi-governmental units and contractors to provide services that traditionally were performed by the civil service. 4/

There can be no doubt that federal spending has been rising. Between fiscal years 1951 and 1981, federal outlays grew 13 and a half times, rising from $45.5 billion to $657.2 billion. Significant growth occurred even when expenditures are expressed in constant dollars, with federal budget outlays increasing over two and a half times during this 30-year period.

Federal budget outlays also increased as a percentage of GNP during this period, although the growth occurred at a much more modest pace. In fiscal year 1951, outlays were about 14.6 percent of GNP; by 1961, this ratio had risen to about 19.2 percent. It rose further to 20.4 percent by 1971, and reached a post-World War II high of 23.0 percent in 1981.

If special factors--such as the increase in prices, the rising cost to the federal government of interest payments on the public debt (most of which was caused by the rise in interest rates rather than the increase in the size of the federal debt), and the decline in recent years of America's rate of economic growth--were taken into account, it could be argued that much of

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4/ See "The Ten Million Federal Employees?" National Journal, May 5, 1979.

the apparent increase in the size of the federal sector over the past 25 years would disappear. Table 2 contains estimates of total federal outlays as a percent of GNP under four conditions: in current dollars, in 1972 constant dollars, in 1972 constant dollars with net interest removed, and in 1972 constant prices under high-employment assumptions with net interest removed. 5/

These estimates, produced by John L. Palmer and Gregory B. Mills, indicate that, while total current dollar federal outlays as a percent of current dollar GNP rose by 6.6 percentage points between fiscal years 1956 and 1981, they only increased by 3.8 percentage points when both expenditures and GNP are measured in constant dollars, indicating that the prices paid by the government rose faster than prices in general. When net interest is deducted from total expenditures expressed in constant dollars, the degree of growth during this 25-year period is further reduced to 2.7 percentage points. Finally, when total outlays minus net interest are calculated in constant dollars under high-employment assumptions and expressed as a percentage of a high-employment economy, the size of the federal sector only increases by 1.3 percentage points between fiscal years 1956 and 1981. Moreover, the estimates in the last column in Table 2 show that, since fiscal year 1966, the federal sector in relation to the economy has grown only by 0.9 percentage points and has remained basically the same size (18.9 percent of high-employment GNP) during the last five years. 6/

The growth rates of state and local expenditures have kept pace with that of federal outlays, although part of this expansion has been fueled by federal grants-in-aid. 7/ With all levels

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5/ John L. Palmer and Isabelle V. Sawhill, eds., The Reagan Experiment (Washington, D.C.: The Urban Institute Press, 1982), Appendix Table A-1.

6/ Some would argue with the usefulness of these statistical manipulations by pointing out that high employment is more of a goal than a consistently achievable level and that government spending itself was partially responsible for increasing the price level.

7/ Between fiscal years 1960 and 1978, federal outlays grew at an average rate of 9.1 percent per year. Total state and local expenditures during this period grew at an average annual rate of 10.5 percent. Even with federal grants excluded, the average annual growth rate for states and localities was 9.1 percent.

TABLE 2. FEDERAL OUTLAYS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT, FISCAL YEARS 1956 TO 1981

Selected Fiscal Year	Total Outlays (in current dollars)	Total Outlays (in constant fiscal year 1972 dollars)	Outlays Excluding Net Interest	
			In constant fiscal year 1972 dollars	In constant fiscal year 1972 dollars under high employment
1956	17.1	18.8	17.6	17.6
1961	19.2	20.2	18.9	17.4
1966	18.6	19.0	17.7	18.0
1971	20.4	20.2	18.8	18.2
1976	22.7	22.3	20.7	18.9
1981	23.7	22.6	20.3	18.9
Increase from 1956 to 1981	6.6	3.8	2.7	1.3

SOURCE: Adapted from John L. Palmer and Isabelle V. Sawhill, eds., The Reagan Experiment (Washington, D. C.: The Urban Institute Press, 1982), Appendix Table A-1. Data drawn from:

1. For total outlays (including budget and off-budget amounts) in current and constant dollars and GNP by fiscal year: Office of Management and Budget, "Federal Government Finances," February 1982, pp. 60-63, 60-70, and 72-75. (Off-budget outlays were converted to constant dollars using the implicit GNP price deflator for federal nondefense purchases of goods and services.)

2. For high-employment budget expenditures in current dollars and for potential GNP in current dollars: Frank de Leeuw and Thomas M. Holloway, "The High-Employment Budget: Revised Estimates and Automatic Inflation Effects," Survey of Current Business, April 1982, pp. 21-33. (High-employment adjustment to actual budget outlays was made in constant dollars using the implicit GNP price deflator for personal consumption expenditures, consistent with OMB constant dollar tabulations. High-employment GNP was converted to constant dollars using the implicit price deflator for total GNP.)

of American government spending at greater rates, the ratio of total governmental expenditures to the GNP rose by about 57 percent from fiscal year 1951 to fiscal year 1981, or from 20.7 percent to 32.4 percent of GNP.

This pattern of almost steady increase in the proportion of national output channelled through the governmental sector has occurred in nearly all industrial democracies. Although political, economic, and demographic factors have been traditionally seen as the major reasons for this growth, 8/ the apparent uniform growth of the public sector is almost all industrial countries has led, in recent years, to speculation that there is an institutional bias toward governmental growth in the decisionmaking processes of representative democracies.

The growth rates and sizes of public sectors vary among industrial democracies, however. Figure 5 shows the evolution of total government outlays (for all levels of government--federal, state and local) as a percentage of the economies of the 13 largest member countries of the OECD during the period 1960 through 1980. The sizes of the public sectors vary from a 1980 high of 65.7 percent of gross domestic product (GDP) in Sweden to a 1980 low of 32.7 percent of GDP in Japan. 9/ Within this range, the United States had one of the smallest and slowest growing public sectors. In 1980 only Japan had a smaller public sector and none of the nations had a slower growing public sector.

Figures 6 and 7 illustrate that there does not appear to be any direct relationship between the size of a nation's public sector and its economic performance. For example, from 1970 through 1980, Japan, which averaged a total public sector 21 percent smaller than that of the United States, had an economy that on the

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8/ At the turn of the twentieth century, Leon Wagner suggested a relationship between economic development, industrialization, and urbanization and the move toward a larger public sector. Daniel Tarschys, "The Growth of Public Expenditures: Nine Modes of Explanation," Scandinavian Political Studies (1975), vol. 10, pp. 9-32.

9/ The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

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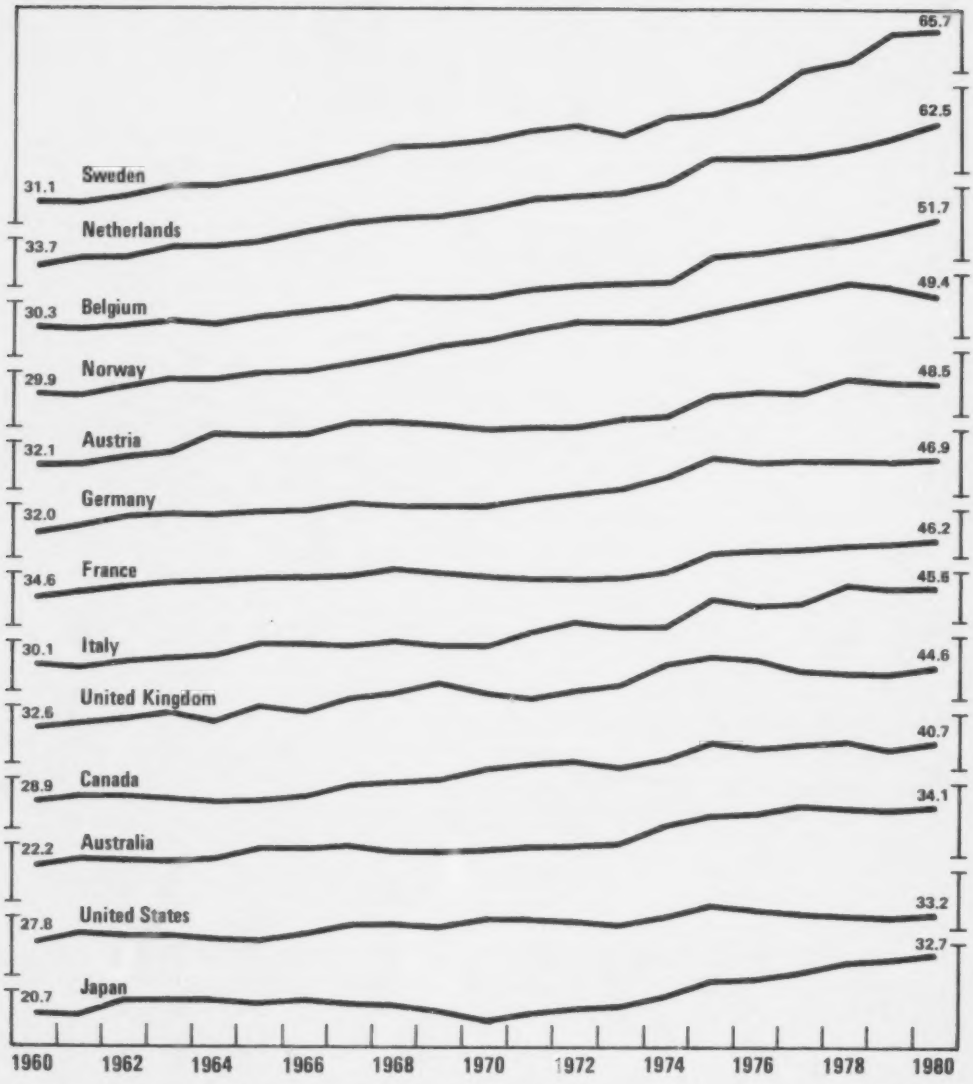
Figure 5.
Evolution of General Government Expenditure[a] 1960-1980
(in percent of GDP[b] at Current prices)



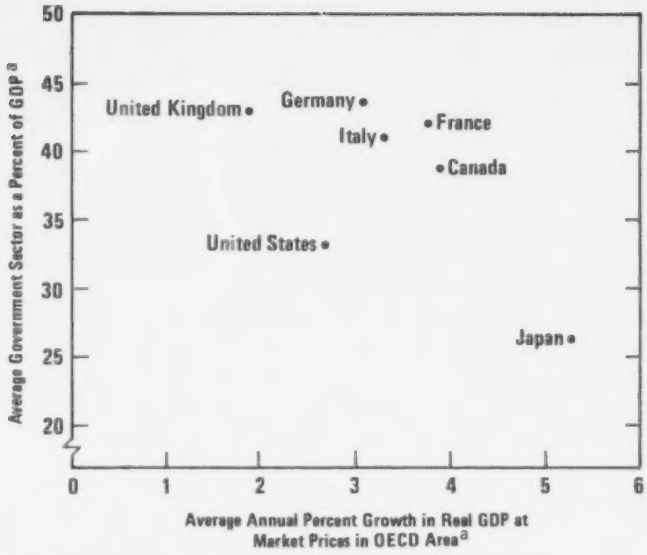
SOURCE: *OECD Economic Outlook*, Volume 31, (July 1982), p. 149.

[a] Includes total expenditures for all levels of government.

[b] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

Figure 6.

Comparison of the Size of the General Government Sector and Real GDP Growth, 1970-1980

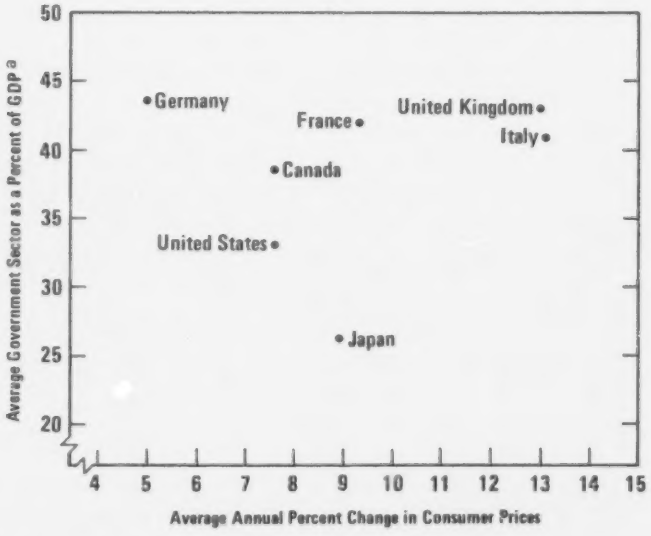


SOURCE:
OECD Economic Outlook,
Volume 31, July 1982.

[a] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

Figure 7.

Comparison of the Size of the General Government Sector and Consumer Price Inflation, 1970-1980



SOURCE:
OECD Economic Outlook,
Volume 31, July 1982.

[a] The GDP is a national income concept based on production within the geographic borders of the country; the GNP covers production by and incomes to citizens of the country no matter where they may live.

average grew at a 96 percent faster rate. During the same period, France's economy outperformed that of the United States by around 41 percent, with a public sector that on the average was 27 percent larger.

The same mixed picture occurs with the relationship of the size of the public sector to the rise in consumer prices. Germany, the country that was the most successful at controlling inflation, averaged a public sector that was a third larger than America's. Japan, the only country with a smaller public sector than the United States, experienced higher consumer inflation during this 11-year period than did the United States.

These patterns can be viewed in two ways. On the one hand, it can be said that nations do have a choice. The United States, moreover, appears to have exercized that choice in favor of a relatively small public sector, by international standards. But, for those who see the growth of the public sector as a danger, the fact that most industrial democracies have larger public sectors than the United States is a warning of the inevitable future under the present decisionmaking process. Moreover, whatever the size and growth rate of the public sector, there may be particular problems with the growth of key portions of the budget.

PATTERNS OF EXPENDITURE GROWTH

Since fiscal year 1960, the growth of federal budget outlays has been caused primarily by the establishment and expansion of federal income assistance programs and, to a lesser extent, by the growth of federal grants to states and localities (see Figure 8). During the early 1950s, this was not the case. Between fiscal years 1950 and 1954--the Korean War years--military spending was the major source of budget growth, with national defense outlays increasing from 29 to 65 percent of all federal expenditures while nondefense outlays actually declined by $5.6 billion. After the Korean period, with the exception of the peak Vietnam War years in the late 1960s, defense outlays declined markedly, so that by 1978 they accounted for only 5.0 percent of GNP--the smallest percentage since 1950--and for 23.5 percent of all federal expenditures --the smallest proportion since 1940. In the early 1980s, this trend was again reversed, with defense outlays 6.2 percent of GNP and 25.8 percent of all federal expenditures in fiscal year 1982.

Since the mid-1960s, outlays for federal income assistance programs--labeled payments to individuals--have risen dramatically, climbing from $32.3 billion in fiscal year 1965 to $316.6 bil-

lion in fiscal year 1981. Funding for these programs--Social Security, railroad retirement, military and civil service retirement, unemployment assistance, veterans' benefits, Medicaid and Medicare, housing assistance, and the various types of welfare--has grown at a much faster rate than that of all other federal activities--148 percent faster since 1965 and 55 percent faster since 1971. Whereas payments to individuals accounted for 27.2 percent of federal outlays, or 4.9 percent of GNP in 1965, 48.2 percent of all federal budgetary expenditures, or 11.1 percent of GNP, was devoted to these purposes in 1981 (see Figure 8).

Outlays for federal grants to state and local governments have also increased dramatically in recent years as the Congress has chosen to decentralize new programs by having them administered by state and local governments. Since fiscal year 1965, these expenditures have grown over eight and a half times, rising from $10.9 billion in that year to $94.8 billion in 1981. This latter figure includes $39.9 billion in outlays that are also contained in the payments-to-individuals category, such as Medicaid, Aid to Families with Dependent Children (AFDC), child nutrition, and housing assistance. Excluding this funding, grants to state and local governments accounted for 8.3 percent of all federal spending in fiscal year 1981. While this type of spending has been growing at a faster rate, it has had less than a third of the dollar effect on the growth of total federal outlays than has payments to individuals, since it started from a smaller base.

During fiscal years 1971 to 1981, the growth of net interest outlays (interest on the public debt minus interest paid to federal government accounts) has been another important source of increased budget expenditures (see Table 2). The increase in net interest outlays relative to GNP was not caused by a rapid growth in the federal debt. The total debt held by the public actually grew less than GNP in the 1971 to 1981 period, with the debt/GNP ratio falling from 29.5 percent in 1971 to 27.8 percent in 1981. Rather, interest outlays grew so rapidly because of the enormous increase in interest rates. In 1971 the average interest rate on new issues of three-month Treasury bills was about 4 percent; by 1981 the average rate was over 14 percent. 10/ While most of the increase in current dollar interest rates probably resulted from

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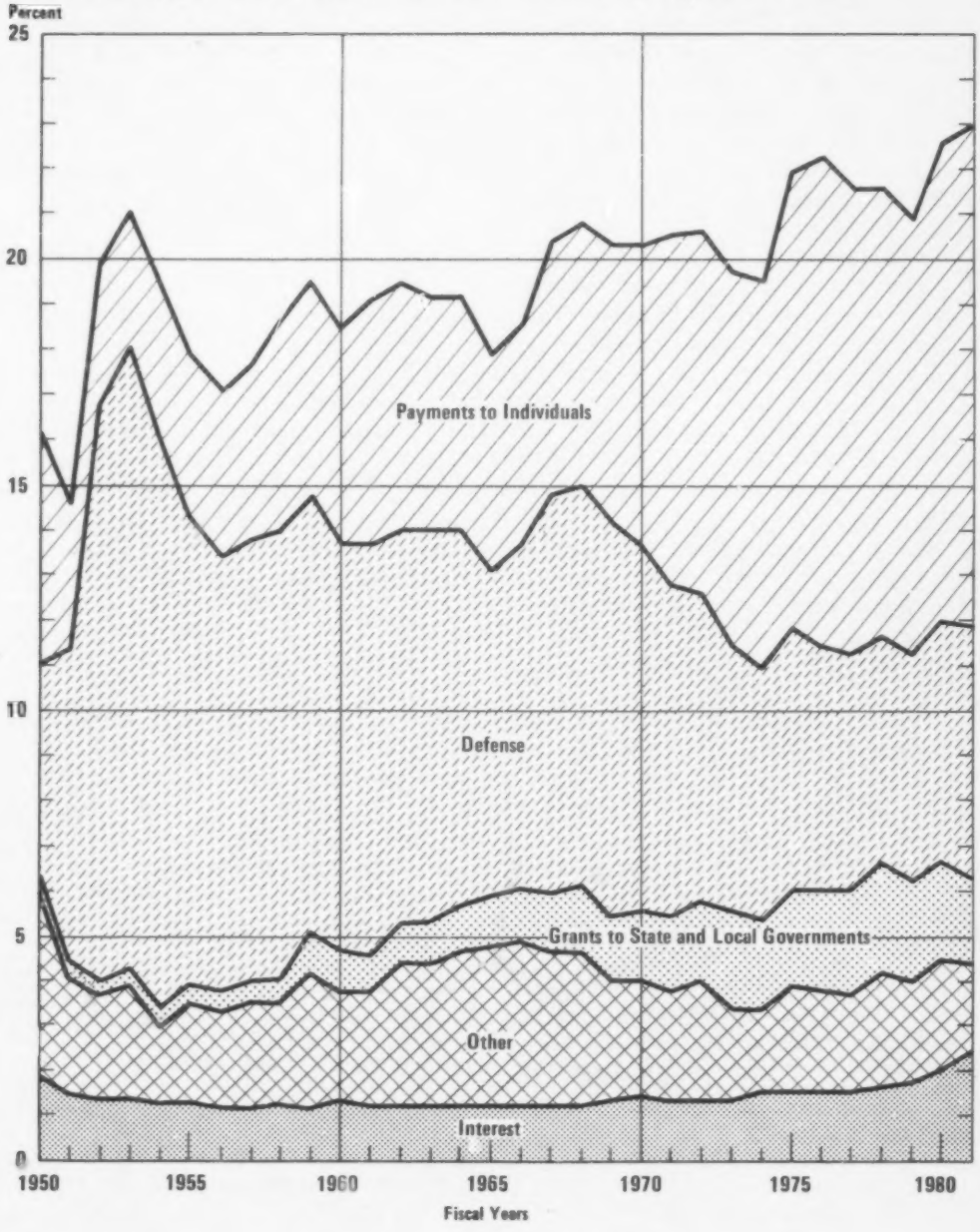
10/ Interest on the debt lags behind current market interest rates because part of the debt is in the form of long-term bonds. However, almost half turns over each year.

Figure 8.

Unified Budget Outlays as a Percent of GNP, by Type of Outlay



the rising rate of inflation (which leads borrowers to demand compensation for the loss of purchasing power on the money lent), there is evidence, especially since 1980, that real interest rates (current dollar interest net of inflation) have risen as well. To the extent that real interest increases persist in the future, federal outlays for net interest may stay relatively high even if inflation subsides. In addition, if the public debt grows rapidly as a result of large budget deficits in the next few years, the interest component of federal outlays will reflect that increase.

Pressures for Higher Spending: Payments to Individuals

Those who see the need to substitute a statutory or constitutional limit for the present budgetary process point to the entitlement structure and the indexing of benefits of income assistance programs as major pressures toward a larger public sector. 11/ By structuring programs as entitlements and indexing their benefits to the inflation rate, it is contended that budgeting is moved from a cash basis (how much can we afford) to a volume basis (how much do we need to maintain current effort). Particularly during inflationary periods, spending for indexed entitlements will lead to a larger public sector, since these programs are insulated from the real reductions that other programs can experience, as the same level of expenditures buys fewer goods and services. 12/ Citing recent trends, critics point out that, if spending for payments to individuals (which includes the major federal entitlement programs) was to continue to grow at the rates of the last 20 years, by the year 2000 outlays for such programs would be over a third of the GNP.

This outcome is improbable, however. In 1975, the Congressional Budget Office (CBO) projected the cost of the then existing income assistance entitlements to the end of this century.

11/ Entitlement programs require a payment or benefit to any person or government meeting the requirements (such as an income test) established by the authorizing legislation setting up the program. Indexed benefits rise automatically at a rate that is tied to a measure of inflation, most commonly the Consumer Price Index (CPI).

12/ Aaron Wildavsky, The Politics of the Budgetary Process, 3rd ed. (Little, Brown and Company, 1979), p. 264.

Whether the projections were carried out assuming current law, adjusting all benefits for inflation, or adjusting all benefits not only for inflation but also for real wage increases, the outlays for these programs were about the same proportion of the GNP at the end of the century as they are today. 13/

Perceived Dangers of Federal Grants to State and Local Governments

Procedurally, the Congress can more easily reduce federal grants to state and local governments than payments to individuals, since, with the exception of those grant programs that are also classified as payments to individuals and general revenue sharing, the grants are subject to the appropriations process, with funding decisions made each year. Because a large portion of the outlays for these programs result from budget authority enacted in prior years, however, the Congress cannot always control grant outlays in the current budget year. It can, however, more easily control future funding since it does not have to change an entitlement formula in the basic authorizing statute, as is the case for most income-assistance programs. Also, the outlays of

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13/ This finding needs two important qualifications. First, these projections assume no new income assistance programs. It should be remembered, for example, that in the past 20 years, food stamps grew from an experiment to a major entitlement program, Social Security replacement rates were substantially raised, and Medicare and Medicaid were started. If the Congress chose to institute a comprehensive national health insurance program, the public sector would undoubtedly grow. Second, if current population projections are correct, basic demographic changes will occur in the first third of the 21st century that will result in significant increases in program costs. As the American population ages, the percent of national income spent on entitlement programs that serve the elderly--such as Social Security, Medicare, and Supplementary Security Income--will increase. For example, while Social Security outlays will remain at approximately 5.6 percent of national income until the end of this century, they will rise to 6.2 percent in 2010, 7.7 in 2020, and 8.8 percent 2030. Growth of Government Spending for Income Assistance: A Matter of Choice, prepared by the Congressional Budget Office for the Senate Committee on the Budget, December 3, 1975, p. 6.

most grant programs are not sensitive to changes in the economy, since they are neither entitlements (with the above noted exceptions) nor indexed to the inflation rate.

On the other hand, while the payments-to-individuals category is made up of a relatively small number of fairly well-known programs that distribute money to a large number of beneficiaries, the grant category is made up of a vast number of programs that serve a smaller number of beneficiaries or indirectly subsidized groups. 14/ As such, grant programs are classic examples of the types of federal activity that critics of the present budget process believe lead to higher and higher levels of spending--programs in which relatively large subsidies per recipient are granted to a few beneficiaries at a relatively small additional cost to individual taxpayers. Elected representatives hear from the beneficiaries, who desire continued or higher subsidies; but even if the taxpayer is aware of the specific issue, protest is unlikely to be regarded as worth the cost of the stamp to make it.

If the bias in budgeting were based on the concentrated benefits doctrine, grants to state and local governments should be the main source of growth in federal expenditures. But, because the grants category accounts for only one-ninth of all federal spending, such an upward bias in grant spending is unlikely to bring about dramatic future increases in total federal expenditures as a proportion of the GNP. A dramatic rise in future spending is likely to be associated with significant increases in defense or payments to individuals. Decisions over such issues are rarely made without a good deal of public and Congressional debate. Moreover, since 1975 the Congress has been provided with five-year

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14/ Using Treasury Accounts as a surrogate for "programs" results in a payments-to-individuals category (all grants excluded) of 45 programs which accounted for $186.4 billion in outlays in fiscal year 1979, or an average of $4.3 billion per program. Grants to state and local governments, on the other hand, consist of 189 programs, which spent $82.1 billion in 1979, or $435 million per program. Using the categories of Direct Payments and Grants as set out in the Catalogue of Federal Domestic Assistance produces similar results. In fiscal year 1979, 65 direct payments programs obligated $192.6 billion, or $3.0 billion per program. The grant category, on the other hand, consisted of 583 programs that obligated $82.0 billion, or $141 million per program.

cost estimates of the expenditures required to create new or expand old entitlement programs. This appears to have had a restraining effect on the expansion of these types of programs.

PUBLIC ATTITUDES TOWARD FEDERAL SPENDING AND DEFICITS

For nearly half a century, polling organizations have been surveying Americans' attitudes about balancing the budget and the appropriate levels of spending and taxation. The questions have been asked in varying forms, but the results have formed a remarkably consistent, if contradictory, pattern over time. Specifically:

- Huge majorities are consistently in favor of a balanced budget.
- Huge majorities are consistently in favor of spending increases in most policy areas.
- During most periods, and consistently over the past ten years, majorities have felt that their taxes were too high.
- The public has a very poor idea of the cost of various types of federal activities, but believes that deficits can be eliminated by getting rid of waste.

In January 1979, for example, a Harris poll found that 69 percent of those sampled favored a constitutional amendment that would require a balanced federal budget. The same percentage favored a cutback in federal spending. 15/ But when asked whether they would favor such a cutback if it meant reductions in spending

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15/ Since 1979 no single poll has continually included questions on a balanced budget amendment and specific program reductions. But in separate polls, the pattern of support for an amendment and opposition to program reductions to achieve a balanced budget has remained. For example, in May 1982 an NBC News/Associated Press poll found that 66 percent of adult Americans favored a balanced budget amendment. In June 1982, 74 percent of the respondents to a Gallup poll supported a balanced budget amendment. In this poll, however, the public rejected eliminating the federal deficit by cutting de-

TABLE 3. PERCENTAGES FAVORING OR OPPOSING A BALANCED BUDGET AMENDMENT AND VARIOUS POTENTIAL SPENDING REDUCTIONS IN JANUARY 1979

	Balanced Budget Amendment	Major Cutback in Federal Spending	Cutback in Specific Program Areas					
			Elderly, Handicapped, and Poor	Health	Education	Defense	Environment	Unemployed
Favor	69	69	19	20	24	31	36	39
Oppose	23	24	78	75	73	62	57	54
Not sure	8	7	3	5	3	7	7	7
Total	100	100	100	100	100	100	100	100

SOURCE: Louis Harris and Associates, telephone survey of 1,498 American adults carried out from January 17 through January 22, 1979.

in specific policy areas, majorities from 54 to 78 percent replied in the negative (see Table 3).

This apparently contradictory set of attitudes can be explained partially by the wording of the questions and partially by

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fense spending or reducing expenditures for social programs by for-and-against votes of 43 to 47 percent and 40 to 51 percent, respectively.

An October 1981 Harris poll found that majorities and pluralities preferred a federal deficit to reducing a number of federal programs--federal aid for the elderly, handicapped, and the poor (80 to 16 percent); social security (75 to 21 percent); health programs (59 to 36 percent); federal aid to education (54 to 42 percent); and defense programs (47 to 46 percent). Only in the case of food stamps did a majority--61 to 36 percent--prefer spending cuts to eliminate the deficit.

the fact that most Americans believe that a balanced budget can be achieved through elimination of government waste. Questions are worded so that respondents are asked about the appropriate level of spending in various policy areas rather than about specific programs. Respondents, moreover, are rarely forced to make the tradeoff between taxing and spending that is required when elected officials put together a budget. Avoiding this tradeoff is made easier by the overwhelming public belief that government wastes a lot of money. A February 1979 NBC News/Associated Press poll, for example, found that 71 percent of its respondents agreed with the statement: "The federal budget could be balanced just by reducing waste and inefficiency."

Americans also appear to have a poor idea of the proportion of governmental spending that is associated with different types of activities. Even when respondents are warned that increased spending will come from their taxes, massive support exists for more spending for those programs that make up the overwhelming proportion of federal outlays. Those programs that the public feels should be cut--maintaining foreign military bases, contributing to the United Nations, furnishing economic aid to less developed countries, and providing military aid to U.S. allies--constitute a very small percentage of total federal expenditures. 16/

WHY NOW?

Given the stability of public attitudes toward spending, taxing, and deficits, why have movements to limit federal deficits, spending, and revenues become so much stronger and more successful in the last few years? While there is no single answer to this question, the following five factors appear to be relevant.

First, throughout American history, demands for budget reform have gained momentum during periods of consistent deficits and sharp expenditure increases. This was true, for example, in the period that led up to the passage of the Budget and Accounting Act of 1921.

Second, for many people inflation is associated with unbalanced budgets, and the rate of inflation has clearly worsened in

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16/ William Watts and Lloyd A. Free, State of the Nation III, (Little, Brown and Company, 1978) pp. 60-69.

recent years. From 1948 through 1967, the Consumer Price Index (CPI) rose at an average annual rate of 1.9 percent. But since 1968, this average has increased almost fourfold--averaging 4.6 percent annually for the 1968-1972 period, 8.2 percent annually for the years 1973-1978, and 11.5 percent annually for the 1979-1981 period. 17/ For the first time, polling organizations are finding that Americans believe that the government, rather than business or labor, is to blame for inflation. Given this setting, it is not surprising that people associate bad economic news with budgetary policies that have traditionally been seen as inherently dangerous.

Third, during the last decade there has been a general slowdown in the growth of real disposable income. Some of this slowdown was caused by the increase in the tax burden. During the first half of the 1970s, for example, total governmental receipts averaged 38.1 percent of personal income. During the second half of the decade this ratio rose--despite periodic federal reductions--until it reached a high of 39.6 percent of personal income in 1978. This tax growth was a major cause of several tax revolts at the state and local level--most notably the passage of Proposition 13 in California and 2-1/2 in Massachusetts. 18/

Although per capita real disposable income (that is, the constant dollar income available after taxes have been paid) continued to rise during the 1970s, it increased at an annual average rate slightly below that of the previous decade. Moreover, much of the increase has only been achieved through a rise in the percentage of Americans who work. In many families, real disposable income would have fallen in recent years if the wife had not gone to work. In 1960 30.5 percent of married women (in families in which the husband was present) held a job. By 1970, this number had climbed to 40.8 percent and by 1980 it had risen to 50.2 percent.

For a theoretical family of four in which only the husband works at a nonagricultural job, for example, real spendable weekly earnings in December 1981 ($146.29 in 1977 dollars) were lower than they had been in 1959 ($149.40 in 1977 dollars). Although

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17/ December over December.

18/ Frank S. Levy, "On Understanding Proposition 13," The Public Interest (Summer 1979).

such statistical constructs should be used with caution, it is clear that for many families real incomes have not risen at all or have only risen because more members of the family have started working or worked longer hours. Thus, it is not surprising that many Americans are unhappy with the record of the federal government's management of the economy. It is also not surprising that, in a world in which many families perceive the economic pie to be stable or shrinking, there is growing concern over the size of the piece taken by government.

Fourth, as already mentioned, many are worried about the decline in American productivity. They argue that federal borrowing has undercut capital formation in the private sector, which in turn has led to reduced productivity growth, which in turn has led to low wage growth. Many economists, however, point to other causes of low productivity, such as demographic changes, requirements for pollution control investment, the increased size of the service sector of the economy, changes in energy prices, less capital per worker, and problems of statistical measurement. 19/

Finally, the movement to end deficits and limit expenditure growth may be an attempt by citizens to control the increase in governmental power, even though much of that increase has occurred in nonspending ways. In recent years, regulations, rules, and mandates appear to have proliferated at a rate almost as rapid as expenditures. Americans are told that they must pay for seat belts and pollution control equipment on their cars, that smoking is not permitted in public places, that they must have pension plans that meet basic minimum standards (Employee Retirement Income Security Act), that their workplace must conform to certain safety specifications (Occupational Safety and Health Act), that funerals and vacation lots can be advertised only in certain ways, that schools have to be integrated according to approved plans, and so on. While frequently supported by the voters on a one-at-a-time basis, the total of such regulations leads to significant economic costs and may contribute to a feeling that the federal government is becoming too powerful.

19/ See Edward F. Denison, Accounting for Slower Economic Growth: The United States in the 1970s (Washington, D.C.: The Brookings Institution, 1979).

CHAPTER III. OPTIONS FOR ACHIEVING ANNUALLY BALANCED BUDGETS AND LIMITATIONS ON EXPENDITURE AND REVENUE GROWTH, SHORT OF STATUTORY OR CONSTITUTIONAL REQUIREMENTS

This chapter describes the types of changes in budgetary procedure, short of formal statutory or constitutional requirements, that have been proposed to bring about annually balanced federal budgets or limitations on the growth of federal expenditures and/or revenues. The next chapter describes the statutory or constitutional options that would mandate balanced budgets or formally limit expenditure growth.

The many bills and Constitutional amendments that have been introduced in the 97th Congress to control deficits and spending can be grouped into three categories. These categories, plus a continuation of current policy, are as follows:

- Current policy that relies on the ballot box to elect a Congress and President who are committed to holding spending and revenues in check and balancing the budget.

- Proposals that seek to provide improved budgetary information for Members of Congress and citizens so that voters can better hold their representatives responsible and so that representatives have a better understanding of the consequences of their votes.

- Proposals that enhance the authority and influence of those Members of Congress and Congressional institutions that are most likely to limit federal spending or balance the budget.

- Proposals that limit Congressional discretion on budgetary questions through statutory or constitutional prohibitions.

This chapter deals with the first three categories; the fourth is discussed in Chapter IV.

CURRENT POLICY

In a representative democracy, there is a classic and simple remedy available to an electorate that is dissatisfied with the expansionary budgetary policy of its government: elect Members of Congress and a President who will balance the budget and check the growth of expenditures and revenues and turn out of office those who will not. 1/ An important function of the budget and the budgetary process is to provide voters with the necessary information to judge their government's actions. 2/ A budget provides this information to the degree that it satisfies "such fundamental standards as visibility, clarity, explicitness, and comprehensiveness." 3/ The budget process provides this information by requiring that elected officials record their positions on the major questions that are answered in every federal budget. Once these informational standards are met, the present system assumes that simple majorities will be sufficient to reach decisions that accurately reflect the will of the people both in the Congress and at the ballot box.

1/ In recent years many seeking a change in policy have relied on procedural reform. Yet there is a good deal of evidence that the ballot box remains the most effective way to bring about a policy change. As put by one student of the Congress: "Popular wisdom portrays the congressman as weak and vacillating, one who sways with every political breeze. But academic studies suggest to the contrary that incumbent congressmen maintain a marked stability in their positions over time. If you wish to know how a congressman is voting in 1970, the chances are good that his 1960 voting record will tell you. As a consequence, the only reliable way to achieve policy change in Congress is to change congressmen." Morris P. Fiorina, Congress: Keystone of the Washington Establishment (Yale University Press, 1977), pp. 12-13.

2/ Arguing for the reforms that were eventually enacted as the Budget and Accounting Act of 1921, President William Howard Taft stated: "The Constitutional purpose of a budget is to make government responsive to public opinion and responsible for its acts." House Doc. No. 458, 62:2 (1912), p. 16.

3/ Louis Fisher, Presidential Spending Power (Princeton University Press, 1975), p. 20.

Federal budgetary reforms in this century--such as the Budget and Accounting Act of 1921, the adoption of the unified budget in 1969, and the Congressional Budget Act of 1974--have sought to cure perceived ills in two ways. First, these reforms have aimed at providing decisionmakers with more and better information so that they would know the consequences of adopting various budgetary alternatives. Second, by requiring those decisionmakers to make their budgetary choices publicly and explicitly, the reforms have attempted to guarantee that voters would have the necessary information to hold their elected officials accountable.

The Nature and Effect of the Congressional Budget Act of 1974

The persistent deficits and rapid rate of federal expenditure growth of the late 1960s and early 1970s were two of the major reasons for the passage of the Congressional Budget Act of 1974. 4/ The act brought about the most fundamental procedural changes since the Budget and Accounting Act of 1921. It reflected the traditional reform approach to budget control in that it relied on increasing the quantity and quality of budgetary information for decisionmakers and voters. The act provided, for the first time, a procedure under which Members of Congress had the opportunity to cast votes on the proper size of the deficit or surplus, the proper magnitude of total federal budgetary expenditures, and the proper allocation of federal resources among types of federal activities. The act also created institutions to provide information on the consequences of various budgetary options and actions.

Most importantly, the new process forced the Congress to consider, debate, and decide on the proper levels of revenues and outlays at the same time. In this way, the act's procedures somewhat countered the past tendency of the Congress to ignore the costs of programs that it enacted. In the past, Members could urge lower levels of spending and smaller deficits while voting for individual pieces of legislation that led to higher spending levels and larger deficits. While the act does not preclude such behavior, it created the two new institutions--the Budget Committees--whose duty it is constantly to remind Members and other committees of the effects of their actions on the budget's totals.

4/ Another major reason for the Act's passage was President Nixon's extensive use of impoundment.

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In so doing, the act increased the political cost of inconsistent voting. Over the long run this could significantly ameliorate any upward bias toward greater spending and larger deficits.

While the act required the Congress to go on record on all major budgetary questions, it was not biased in any policy direction. It did not mandate annually balanced budgets or a check on expenditure growth. Rather, in the traditional manner, it tried to give greater budgetary control to Members of Congress by giving them an opportunity to vote in an informed way on budgetary questions and to give the public more information on the budgetary positions of their Congressmen.

Has this most recent reform been effective in bringing about smaller deficits and in checking expenditure or revenue growth? The Congressional Budget Act was implemented during the most severe recession since the Great Depression of the 1930s. Under these conditions, the public was in favor of federal policies to foster recovery and lower the unemployment rate. After supporting economic recovery measures early in the Carter Administration, the Congress began to adopt policies to counter the rapid increase in the rate of inflation during the last years of the 1970s. One effect of these policies was to reduce the rate of growth of non-defense, noninterest expenditures. Thus, while these outlays, measured in constant dollars, grew at a 7.5 percent annual rate from 1970 through 1977, they only increased at a 2.5 percent annual rate during the 1978-1981 period.

Since 1981 the Country has experienced a recession with the highest unemployment rate in the postwar period. In contrast to actions during earlier recessionary periods, the Congress, following the lead of the Reagan Administration, has enacted a series of very large reductions in domestic expenditures, instead of adopting countercyclical spending programs.

Those who feel that the act has been successful cite individual cases in which additional spending or greater deficits were rejected on the recommendation of the Budget Committees. Those who are disappointed with the effect of the new procedures point to the continued pattern of large deficits and rapid growth of expenditures. The one empirical study that has been published found no systematic differences in Congressional budgetary policy resulting from the new budgetary procedures. 5/

5/ L. Douglas Lee, "The Impact of the Congressional Budget Act on Fiscal Policy" (paper delivered at the 1978 annual meeting of the American Economic Association, Chicago, Illinois, August 29, 1978).

The visibility of the budget under the reformed Congressional process may contribute to curbing spending and deficits. Studies of several countries have shown that electoral reaction to the growth of taxation and government expenditure is related to the visibility of the tax system and expenditure programs. Countries that relied on general revenue taxes and channeled national resources into labor-intensive, government-supplied services experienced an electoral backlash in the early 1970s while those that relied on indirect and programmatic (earmarked) taxes and channeled national resources into cash transfers did not. 6/ If this analysis is correct, the increased visibility of the new budget process should create electoral pressure which, if sustained, will lead to fewer deficits and a check on expenditure growth.

PROPOSALS TO PROVIDE MORE INFORMATION AND VISIBILITY

Currently, there are a number of proposals before the Congress that would continue the tradition of creating greater budgetary control through requiring Congressional decisionmaking on all major budgetary questions and providing increased information for decisionmakers and voters. These proposals include multiyear targeting, sunset legislation, moving off-budget agencies onto the budget, credit budgeting, tax expenditure budgeting, and additional five-year costing requirements.

Multiyear Budgeting

Until the late 1970s, the Congress acted solely on the next year's budget. With such one-year-at-a-time budgeting, the Congress could not properly consider the future effects of current budget decisions. This, in turn, made it more difficult to achieve budgetary goals. It is neither possible nor desirable to change the budget dramatically in the course of one year. In any year, about three-fourths of federal spending is considered "uncontrollable" in that it either results from budget authority passed in prior years or is mandated by entitlement legislation

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6/ Douglas A. Hibbs, Jr. and Henrik J. Madsen, "Public Reaction to the Growth of Taxation and Government Expenditure: A Preliminary Comparative Investigation" (paper delivered at the 1979 annual meeting of the American Political Science Association, Washington, D.C., September 3, 1979).

passed in prior years or is mandated by entitlement legislation and fixed-cost programs. 7/ Moreover, since many of these programs contain government commitments to provide benefits and services on which people rely, it probably would be undesirable to terminate these commitments on short notice. Few citizens would want to live in a country in which the government did not honor its commitments--in which the aged, handicapped, and other recipients of federal benefits were never certain whether they would continue to receive their checks.

A similar logic is applicable to the receipts side of the budget. Few citizens or corporations would want to live in a country in which frequent and rapid changes were made in the structure of federal tax legislation. In fact, many have argued that the temporary nature of much of the 1970s' tax legislation negated much of its positive effect on the economy, since individuals and corporations could not make long-term plans based on a certain knowledge of what federal tax policies would be in the foreseeable future.

Thus, to achieve a major shift either in the size or in the mix of the budget, the Congress has to act over a number of budget cycles. In order to control the effects of these actions, the Congress also must know the future consequences of today's actions, so that planned changes will have the anticipated results.

Since the enactment of the Congressional Budget Act of 1974, multiyear budgetary procedures have expanded in stages and are now a central part of the Congressional budget process. The budget act itself requires the Congressional Budget Office (CBO) to produce five-year cost estimats for all spending and tax expenditure legislation that comes to the floor of either the House or the Senate. It also requires the Office of Management and Budget to prepare a current services budget showing what would occur if last year's budget policies were carried out into the future. From the implementation of the budget act in 1975, CBO, at the request of the Budget Committees, has produced its own five-year current policy projections so that the committees could see the effects of aggregate administration and Congressional proposals on a multiyear basis.

7/ Budget authority provides by law (usually an appropriations act) the basis for federal agencies to enter into commitments that result in immediate or future outlays.

Beginning with the Ford Administration, current policy multiyear projections of the President's budget proposals have been included in his budget. Over time these current policy projections shifted to multiyear budget plans that incorporated current budgetary proposals in the outyears.

In the late 1970s, the Budget Committees incorporated in their concurrent budget resolutions multiyear targets, which had previously been included only in the reports accompanying the resolutions. With this change, the Congress could debate and vote on multiyear budget plans. Although the second, third, and fourth years of these plans are always treated as targets, subject to modification at any time, they provide the Congress with an understanding of the alternative sets of multiple steps required to reach major shifts in budget priorities.

With the initial implementation of the reconciliation procedure during the fiscal year 1981 budget cycle, 8/ the advantages of multiyear budgeting as a control mechanism became apparent. The budget resolution that year specified only one year's worth of budget savings. Accordingly, many of the savings of the reconciliation bill (the Omnibus Reconciliation Act of 1980) only affected the budget in one year. In some cases, however, what appeared to be a saving in the first year led to additional outlays in future years. The reconciliation procedures that were used in 1981 and 1982, therefore, required the various Congressional committees to make changes that would achieve budgetary savings not only in the upcoming fiscal year but also in the two succeeding fiscal years as well.

As the Congress moves to reduce the currently projected large deficits, there is now general acceptance that to succeed it will have to plan and act in a multiyear fashion. From a policy perspective, the multiyear approach is neutural; it does not prescribe an outcome, such as a balanced budget or constrained expenditure growth. For example, the expansion of defense spending and the tax reductions of 1981 that, along with the current recession, are responsible for the prospect of continuing large federal

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8/ Reconciliation refers to a set of instructions contained in a budget resolution requiring that specific outlay savings or revenue increases be reported by committees with the appropriate jurisdiction. These reports are then incorporated into a reconciliation bill or resolution.

deficits, wre both developed in a multiyear framework. In the fall of 1979 the multiyear targets of the Second Concurrent Resolution on the Fiscal Year 1980 Budget were amended on the floor of the Senate to adopt a multiyear plan that would commit the nation to five years of five percent real growth in defense appropriations. The Kemp-Roth tax proposal, which became a central part of the Reagan Administration's economic program, was initially designed and eventually implemented as a multiyear series of tax reductions.

Although as currently practiced multiyear budgeting does not mandate or guarantee annually balanced budgets or a smaller public sector, it does provide the Congress with a mechanism to achieve these goals if they are desired. It is possible to modify current multiyear procedures to create incentives so that they would increase the chance of eliminating deficits and/or reducing the rate of expenditure growth. One alternative that has been suggested is to enact a multiyear tax reduction that would only occur if the Congress (or the nation) met certain other goals. If one assumes, for example, that it is easier for the Congress to reduce taxes than to cut expenditures, a series of multiyear tax reductions could be enacted that would only take effect if the Congress met a series of budgetary goals to reduce outlays during the following four years. Such a plan was first suggested by Senators Nunn, Bellmon, and Chiles as an amendment to H.R. 13511, The Revenue Act of 1978. (The amendment was reduced to a nonbinding national policy goal in the Conference Committee.) 9/ Those in favor of this proposal hoped that the traditional public desire and pressure for tax cuts would counterbalance the tendency toward expenditure growth and thus make it more politically attractive for the Congress to limit spending and balance the budget.

9/ Section 2 of P.L. 95-600, the Revenue Act of 1978, reads as follows: "As a matter of national policy the rate of growth in federal outlays, adjusted for inflation, should not exceed 1 percent per year between fiscal year 1979 and fiscal year 1983; Federal outlays as a percentage of gross national product should decline to below 21 percent in fiscal year 1980, 20.5 percent in fiscal year 1981, 20 percent in fiscal year 1982, and 19.5 percent in fiscal year 1983; and the Federal budget should be balanced in fiscal years 1982 and 1983. If these conditions are met, it is the intention that the tax-writing committees of Congress will report legislation providing significant tax reductions for individuals to the extent that these tax reductions are justified in the light of prevailing and expected economic conditions."

The Nunn, Bellmon, Chiles proposal differs from both the traditional reform measures and more stringent reforms in that it is aimed at creating new political incentives among the electorate. As such, it could be more effective in achieving balanced budgets and slowing expenditure growth than an unbiased multiyear targeting approach. It is also more flexible than the mandated prohibition proposals.

Sunset Legislation

So-called "sunset bills" would bring about two major changes in the present budgetary process. First, by requiring automatic termination of programs that fail to be reauthorized on fixed schedule, the sunset concept would end permanent authorizations and shift the burden of proof from those who want to eliminate programs to those who desire their retention. Second, by requiring programs with similar objectives to be reauthorized during the same session of the Congress, sunset bills would attempt to facilitate an elimination of overlapping and duplicating programs.

Under one proposal for sunset legislation (S. 2), which passed the Senate during the 95th Congress, most tax and spending programs would come up for scrutiny, review, and reauthorization on a regular timetable. 10/ Congressional decisions to retain, scrap, or modify programs would be aided by a series of analyses provided by Executive and Congressional agencies. Most importantly, the reauthorization cycle would be organized so that all programs in a given subject area (health, education, and so forth) would be considered at the same time.

Many of the proponents of sunset legislation believe that its implementation would lead to slower growth of federal spending. Others doubt this, since most programs covered by the bills under consideration already must be reauthorized periodically. Those spending reductions that did occur most likely would be the result of the improved information required by the process rather than any mandated limitations.

10/ A version of this proposal--H.R. 2--was introduced in the 97th Congress by Representative James Blanchard. An alternative version--H.R. 58--was introduced by Representative Gillis Long.

Measures to Make the Budget More Comprehensive

In a representative system of government, public opinion cannot check spending if that spending is hidden from view. Two ways of hiding expenditures are granting federal entities off-budget status and substituting federal credit assistance for direct federal outlays. The traditional reforms to overcome these problems are putting off-budget agencies back into the budget and creating a mechanism--such as a credit section in budget resolutions--that would allow the Congress to make conscious decisions about the proper level and mix of federal credit activity.

Put the Off-Budget Agencies Into the Budget. Off-budget federal agencies are federally owned and controlled entities whose financial transactions have been legislatively excluded from the totals of the unified budget. There are currently five off-budget federal entities--the Federal Financing Bank (FFB), the Strategic Petroleum Reserve account, the Postal Service fund, the U.S. Railway Association, and the Synthetic Fuels Corporation. In fiscal year 1981 these agencies spent $21.0 billion, mostly through the FFB. Including these entities in the budget totals would increase outlays and the budget deficit by that amount. 11/

To achieve off-budget status, an activity must be so classified by law. Off-budget status, however, is an aberration in current budgetary policy. In 1967, the President's Commission on Budget Concepts recommended that an integrated and comprehensive statement of government accounts be used. A "unified budget," according to the Commission, would function as an information and reporting system and as an indispensable tool in making allocation decisions. The Commission was emphatic about the need for including in the unified budget all activities of the federal government. 12/

Despite this strong recommendation, the Congress excluded a number of agencies from the budget totals in succeeding years. The exemption from the budget totals became a special advantage in

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11/ The public debt would be unchanged, however, since the spending of off-budget entities already requires borrowing from the public.

12/ Report of the President's Commission on Budget Concepts, (October 1967), p. 25.

the period when President Nixon impounded funds to keep federal spending below various ceilings. By keeping programs out of the budget totals and thus "out of sight," advocates hoped to keep their programs out of mind when impoundments were considered.

Since the passage of the Congressional Budget Act of 1974, challenges to off-budget entities have been made on two fronts. First, a number of bills have directed that specific off-budget entities be recorded in the budget. In 1976 an amendment to the Export-Import Bank Amendments put that agency's financial dealings in the budget. Provisions in the appropriations bills for fiscal years 1978 and 1979 for the Department of Housing and Urban Development (HUD) required inclusion of the Housing for the Elderly or Handicapped Fund in the unified budget. The Exchange Stabilization Fund Expense Act, passed in 1977, requires that the administrative expenses of the monetary activities of the Exchange Stabilization Fund be included in the unified budget and be subject to appropriation. A number of bills were introduced in the 95th Congress to put the Federal Financing Bank on budget.

Second, the House Budget Committee has consistently recommended that all off-budget agencies, with the possible exception of the Exchange Stabilization Fund and the FFB, be included in the unified budget. Representative Holt has introduced a bill (H.R. 325) in the 97th Congress that would achieve a generic solution to the problem by putting all off-budget agencies back onto the budget beginning in fiscal year 1983. 13/ Senator Proxmire and Representative Gradison have introduced companion bills--S. 2162 and H.R. 5925--that would eliminate the off-budget status of the FFB, require the Director of the Office of Management and Budget (OMB) to show the budgetary impact of FFB activity in the accounts of the agencies originating the activity, and require all agencies to present their borrowing requirements to the Treasury before seeking other avenues of raising money. 14/

13/ Representative Bethune has introduced a similar bill--H.R. 5109.

14/ Under current accounting procedures, when the FFB purchases loans from a federal agency the only resulting outlay shown on the federal books is for the off-budget FFB. The original provision of the loan by the agency is cancelled by its sale of the loan asset to the FFB, thus obscuring where the federal assistance was rendered.

TABLE 4. NEW COMMITMENTS FOR FEDERAL CREDIT ACTIVITIES (By fiscal year, in billions of dollars)

New Commitments	1976	1977	1978	1979	1980	1981	Percentage Growth 1976-1981
On Budget							
Direct loans	20.6	25.3	35.2	33.9	39.6	40.9	98.5
Off Budget							
Direct loans	14.7	20.5	23.1	17.5	23.6	31.5	114.3
Guaranteed loans a/	26.1	58.8	55.0	86.9	82.2	76.5	193.1
Total	61.4	104.6	113.3	138.3	145.4	148.9	142.5

a/ Amounts shown are new commitments for primary guarantees. Secondary guarantees and agency guaranteed loans held as direct loans by the FFB are deducted from gross loan guarantee commitments to avoid double-counting. See Budget of the United States Government, Fiscal Years 1977-1983, Special Analysis on Federal Credit.

Control Federal Credit Programs. Federal credit assistance includes direct loans and guaranteed loans. The new commitments for each of these credit activities since fiscal year 1975 are set out in Table 4. Of the $151.5 billion in new credit commitments that were made in fiscal year 1981, only one-quarter were originated by on-budget agencies.

Since the implementation of the Congressional Budget Act, new federal credit commitments have increased at a much faster rate (142.5 percent between fiscal years 1976 and 1981) than have federal expenditures. This increase, moreover, has been concentrated in off-budget activities; while on-budget direct loans rose by 98.5 percent, direct loans by off-budget agencies rose by 114.3 percent and off-budget loan guarantees increased by 193.1 percent. It would appear, therefore, that as the Congressional Budget Act's

new procedures restrained unified budget spending, the pressure for a larger public sector found an outlet in off-budget expenditures. 15/ 16/ 17/

To gain control over this burgeoning credit activity, the Congress has established a separate section in their concurrent resolutions on the budget to set targets for gross direct lending and gross new loan guarantees. These targets were established for the aggregate and the 19 budget functions. The first concurrent resolution for fiscal year 1983 requires that these targets be allocated to the various Congressional committees (following the procedures used for ordinary spending as outlined in sections 302(a) and (b) of the Budget Act). All newly authorized credit activity must be subject to an appropriation.

Other Proposals to Provide More Budgetary Information

Many bills have been introduced in recent years to require Executive and Congressional agencies to produce more and better budgetary information. In 1978, for example, at the request of the Senate Appropriations and Budget Committees, CBO agreed to produce estimates of the impact on inflation for a selected number of bills each year. In 1981 the Congress amended the Budget

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15/ The reallocation of credit resources through federal action can also have economic effects, perhaps as great as those of direct expenditures.

16/ Other countries have experienced similar shifts to off-budget borrowing following the tightening of their budget procedures. In 1975 Canada instituted a system of budget control targets. Since that year, "off-budget borrowing by major Crown Corporations has grown from virtually zero in 1975-76 to $1.2 billion in 1979-80 while loans, investments and advances included in government outlays fell from 7.5 percent of outlays in 1975-76 to only 2.3 percent in 1979-1980." Canadian Government, Controlling Public Expenditures --the Canadian Experience (paper prepared for OECD seminar "Controlling Public Expenditures," Paris, May 1980), p. 6.

17/ Another factor spurring the growth of these programs is the increasing attractiveness of the subsidized interest rates in many of them as market interest rates rose.

Act (in P.L. 97-108) to require CBO to produce multiyear estimates of the costs incurred by state and local governments in carrying out or complying with new federal legislation. Bills have also been introduced that would require the Treasury Department to produce annual consolidated financial statements for the U.S. government, the Executive Branch to prepare economic impact statements on proposed rules and regulations, and CBO to produce weekly totals of the average cost for each taxpaying family for newly introduced bills.

Each of these proposed measures is aimed not only at providing better information for Members of Congress so that they can judge the usefulness of bills in light of their costs, but also at giving voters the information needed to hold their representatives accountable. As such, these reforms are unlikely to change present budgetary patterns dramatically.

Simplifying Budgetary Procedures

During the past few years, budgetary issues have come to dominate Congressional activity. Increasingly, many Members have begun to feel that the constant demands of the budget process are consuming time needed to study, debate, and enact other legislation. Additionally, as budget resolutions and reconciliation bills have constituted more of the House and Senate workload, many Members have complained about the confusion caused by varying sets of budget estimates and economic assumptions. In response to these complaints, several Members have suggested modifications to the budget process that would:

- Ease the budget workload, and
- Clarify the budget debate by obtaining agreement among the various budgetary participants on economic assumptions.

Institute Biennial Budgeting. Following the practice of several states, it has been suggested that the Congress move to a two-year budget cycle. Such a procedure would eliminate the necessity of attempting to examine each federal program every year. Many contend that, in practice, the Congress cannot examine every program in detail every year. By attempting to do so, the Congress uses time that could be allocated to thorough review of the programs that are of vital importance to the budget agenda

at the time. The advocates of biennial budgeting believe that it would enable the Congress to manage its workload better. As with multiyear targeting, biennial budgeting would be flexible, permitting the House and Senate to take up any budget matter in either year.

Obtain Agreement on Common Economic Assumptions. During the 1981 budget debate, many Members complained that the array of economic assumptions used for various alternatives caused needless confusion. The variety of sets of economic assumptions made it almost impossible for Members to judge the policy differences among the various proposals. To overcome this problem, some have suggested that the two Budget Committees should agree on a common set of economic assumptions as a baseline. Individual Members, however, would still be free to use other sets of assumptions if they believed that their proposals would change future economic conditions. But at least one set of common assumptions would be available so that Members could compare the policy differences among alternatives.

Three alternatives have been suggested for creating common economic assumptions. The first would require the majority and minority leadership of the Budget Committees to meet and agree on a compromise set of assumptions. The second would use a simple formula to create economic assumptions, based on an extrapolation of past economic performance. 18/ The third alternative would use a standardized set of economic indicators--such as those that would result from a constant unemployment rate--to cost out the various alternatives. 19/

18/ For example, Rudolph Penner has suggested that, beyond the first year of the assumptions (which would be set by a consensus forecast), the projections of real growth in the economy and inflation be based on the average experience of the previous five years. See Rudolph G. Penner, "Budget Assumptions and Budget Outcomes," The AEI Economist (Washington, D.C.: The American Enterprise Institute, August 1981).

19/ See Charles L. Schultze, "Comments on: Forecasting Budget Totals: Why Can't We Get It Right?, by Rudy Penner," (paper presented at the Committee for a Responsible Federal Budget's Symposium on the Fate and Future of the Congressional Budget Process, Princeton, New Jersey, June 12, 1982).

Eliminate the Second Budget Resolution. Since changing economic conditions have required three or more budget resolutions in each of the last six fiscal years, many Members have advocated eliminating the requirement that a second budget resolution be enacted by September 15th of each year. Under such a procedure, the aggregate targets of the first budget resolution would become binding budget authority and outlay ceilings and revenue floors at the beginning of the fiscal year. 20/ This procedure was included in the first concurrent resolution on the budget for fiscal year 1983. Congress still could modify the first resolution by adopting second, third or even fourth budget resolutions should changed economic or political conditions warrant them.

INCREASE THE AUTHORITY AND INFLUENCE OF THOSE REPRESENTATIVES AND INSTITUTIONS MOST LIKELY TO LIMIT FEDERAL SPENDING OR BALANCE THE BUDGET

Before the mid-1960s, the appropriations and taxing committees of the Congress attracted and recruited relatively conservative Members, who were assigned to subcommittees in which they could not enhance the vested interests of their districts. 21/ The Congressional reforms of the last decade or so have changed this pattern. Committee assignments are now largely determined by votes within the Democratic Caucus and the Republican Conference. Subcommittee assignments are determined largely by a combination of seniority and request. The authority of committee chairmen and, to some extent, the House and Senate leadership,

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20/ The budget act specifies that only the second resolution on the budget be "binding." Binding here means that any bill that would breach the spending ceiling or tax floor of the resolution could be blocked by a single Member's objection.

21/ Richard Fenno, The Power of the Purse: Appropriation Politics in Congress (Little Brown and Company, 1966), pp. 138-143. For example, Representative John Taber, Ranking Minority Member of the House Appropriations Committee, was quoted by Fenno in the early 1960s: "I'd rather put a man on a subcommittee where he doesn't have any special interests. If a man has a Navy yard in his district, I would not put him on [the] Military Construction [Committee]. I'd rather not put a farmer on the Agriculture Subcommittee. He couldn't see things so clearly."

has declined. During this same period, the ability of the traditional spending and taxing committees to limit spending has also declined.

Although it would go against the dispersal-of-power goals of the reforms adopted over the last decade, one option for achieving annually balanced budgets and slowing the growth of expenditures would be to assign to the budget, appropriations, and taxing committees those members of each political party who would be least likely to enhance the special interests of their districts through committee or subcommittee membership.

Increase the Authority of the Budget Committees

If past patterns hold, it is likely that over time the Budget Committees will attract Members who are interested in limiting spending and balancing the budget. Increasing the authority and influence of the Budget Committees would enhance the probability of achieving these goals. Two suggested proposals to enhance the Budget Committees' influence are discussed below.

Make Membership on the House Budget Committee Permanent. Currently members of the House Budget Committee (HBC) cannot serve for more than six years of a ten-year period. 22/ In addition, five members of the HBC must also serve on the House Appropriations Committee, five on the Ways and Means Committee, and one member each from the leadership of each party. Some have argued that, as long as the HBC has rotating and representative membership, committee members will not develop loyalty to a set of committee goals and expectations. This view holds that today HBC members represent mainly the various groups of the House. Permanent membership, it is believed, would create a group of Congressmen whose loyalty would be to committee goals of guarding the Treasury and eliminating deficits. The opposite view stresses the need for the HBC to represent the various groups in the House, so that it will not become a supercommittee, dictating budget policy to the other committees.

22/ Unless they are elected chairman in their fifth year of service, in which case they can serve eight of ten years.

Expand the Use of Reconciliation. Reconciliation consists of a process and a piece of legislation. The reconciliation process refers to the procedures that are used to bring about the enactment of a reconciliation bill. The process begins with a set of reconciliation instructions. These instructions, contained in budget resolutions, mandate that various committees of the House and Senate report out legislation by a certain date that achieves certain money targets. The various committees are free to achieve the savings (or in the case of the tax committees, the additional revenues) from the legislation under their jurisdictions as they see fit. Once the committees approve their changes, the Budget Committees of each chamber consolidate them into a reconciliation bill. That bill is then sent to the floor for debate and approval.

When the Budget Act was passed, it was assumed that the reconciliation process would be invoked in the second budget resolution. At that time adjustments would be made in appropriations bills recently passed to make them conform to the second resolution. It quickly became evident, however, that the second resolution came too late in the Congressional session to allow the other committees of the Congress enough time to make the required necessary changes in the programs under their jurisdictions. This was true not only for the Appropriations Committees but especially for the legislative committees that had jurisdiction over the major entitlement programs. Beginning with the fiscal year 1981 budget, therefore, reconciliation has been invoked with the first budget resolution. Because, under the budget process, appropriations bills cannot come to the floor of either chamber until the first concurrent resolution has been passed, moving reconciliation from the second to the first resolution has shifted the burden of reconciliation cuts from those programs whose funds are appropriated annually to those programs--mostly entitlements granting payments to individuals--whose spending levels are set by the rules contained in their authorizations. 23/

23/ In the Omnibus Reconciliation Act of 1981 (P.L. 97-35) the Appropriations Committees were affected by a reconcilation act enacted before the passage of most appropriations bills. This was accomplished by requiring the legislative committees to amend laws within their jurisdictions to lower authorizations of appropriations (which place an upper limit on the amount of budget authority that can be granted in the appropriations process for programs). By lowering the limit

During the last three budget cycles, the Congress has successfully implemented its reconciliation process to achieve significant reductions in expenditures and to raise additional revenues. At the least, it would appear that the reconcilation process provides the most effective existing procedure to reduce the growth rate of federal spending and to eliminate federal budget deficits. At most, a case can be made that the expanded use of reconcilation would eliminate the need for an expenditure limitation or a balanced budget amendment.

The current reconciliation process contains three great advantages for Members who are interested in reducing federal expenditures. First, it makes possible changes in the type of program--entitlements--that has been primarily responsible for the growth in domestic federal spending over the past two decades.

Second, reconciliation instructions provide a tool to force action. Because most entitlements either have a permanent or a multiyear authorization, in the past the opponents of reducing federal domestic expenditures simply had to prevent legislative changes in order to maintain the service levels of their favorite programs. This is in sharp contrast with programs that require annual appropriations. In the latter case, advocates of continued spending must pass a law in order to attain desired spending levels. Reconciliation provides a way for each House as a whole to force the program advocates to act on authorizations during periods of budget constraint. As such, it is a major tool to convert formerly "uncontrollable" into "controllable" spending.

Finally, by grouping many changes into a single bill, the reconciliation process has the potential to shift the political debate from the merits of the parts to the virtue of the whole. As set out in the next chapter, those who believe that the current system is biased toward ever greater levels of spending point to the fact that, while the recipients of a federal subsidy will work

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below the prior year's appropriations, the reconciliation act, in effect, forced the appropriations committees to make reductions. Given the negative reaction by many Members to this procedure, however, it is unlikely that it will be used again in the near future. One can expect, therefore, that future reconciliation acts will be directed mainly at changes in tax and entitlement legislation.

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very hard to obtain, maintain, and enhance their payment, the individual taxpayer will not try to eliminate the few dollars a single subsidy will add to his tax bill. But by grouping many subsidies into a single bill, the individual taxpayer can see the total cost and may be motivated to fight for a fairly large tax reduction (or to prevent a fairly large tax increase). Under such circumstances, the debate between those desiring subsidies and those wanting lower taxes is more balanced.

This concentration on the merits of the entire package is especially evident when, as in 1981 the Congress voted on packaged substitutes to the whole reconciliation bill rather than amendments to individual program provisions. Those who seek to achieve lower federal spending, therefore, would benefit from a requirement that all floor modifications to a reconciliation bill be in the form of substitutes.

CHAPTER IV. LEGISLATIVE AND CONSTITUTIONAL OPTIONS THAT WOULD REQUIRE BALANCED BUDGETS OR LIMIT EXPENDITURE GROWTH

An increasing number of Members of Congress and observers of the budgetary process believe that the perceived ills of the current system cannot be cured by more and better information and requirements that decisionmakers take public positions on budgetary questions. They feel that such procedural reforms will not help because the system itself is biased. According to this view, the unrestricted discretion of the federal government to choose the size and means of financing the budget leads to excessive governmental growth and deficits. To correct this bias, these critics advocate statutory or Constitutional limits on expenditure growth and deficits, change from simple majorities to larger concurrent majorities--such as three-fifths, two-thirds, or three-fourths--or some combination of these more stringent mechanisms.

THE PROBLEM: SYSTEM BIAS IN FAVOR OF INCREASED EXPENDITURES AND DEFICITS

Critics of the current budgetary process contend that the principal cause of the system's bias is the concentrated benefits and diffuse costs associated with each government program and policy. Since the direction of the bias is toward higher and higher levels of expenditures, the bias, accompanied by relatively successful control over the growth of revenues, leads to persistent deficits.

While each federal outlay yields benefits to someone, the distribution of benefits from specific programs is quite uneven, with some individuals benefiting greatly, and others only a little, if at all. Because the cost of any single government outlay, by contrast, is spread out more evenly across all taxpayers, it is very low for each individual taxpayer. Thus, an expenditure that provides large benefits to a few people may cost the average taxpayer less than a penny a day. 1/

1/ The concentrated benefits-dispersed cost theorem is also applicable to tax legislation. The recipients of a tax expenditure will work hard for its creation or expansion while the average taxpayer will not be motivated to oppose it. To the extent that this is the case, federal revenues will be lower than otherwise would be the case and deficits will be higher.

Consider a hypothetical program, for example, through which the government subsidized a particular industry on the grounds that it would be useful to have it in operation in the event of war. If the subsidy were $500 million annually, and about 50,000 people worked in this or direct-support industries, the subsidy would amount to about $10,000 per worker per year. In contrast, the cost of the subsidy would be less than a cent a day for each taxpayer. In return the taxpayers might enjoy a better defense.

If the subsidy were to be withdrawn, those employed in this industry would have to move into other lines of work, earn less, or both. Moreover, because of the potential gains, those connected with the industry--employers and workers--would be willing to expend large amounts of time, energy, and money to persuade policymakers of the need to enlarge the subsidy. Without effective opposition, these efforts would probably succeed. Those who believe that the present system is biased feel that there would be no effective opposition from the general public, the bureaucracy, other interest groups, or elected officials.

The general public would not oppose the increased subsidy because a large percentage increase in one subsidy would only slightly affect the tax bill of the average taxpayer. Even a 50 percent increase in the hypothetical defense industry subsidy would only increase taxes $2.70 per taxpayer per year. Thus, the average taxpayer probably would be willing to support--or at least not oppose--the increase. But what if 200 subsidy programs were increased by the same amount? Then the taxpayer, who would not oppose any single increase, would be most unhappy with the total increase. Instead of a $2.70 tax increase, his taxes would rise by $540. Thus, a pattern develops in which voters approve or acquiesce to individual program growth but object to the sum of total program growth.

The bureaucracy would not oppose the increased subsidy because, say the critics, the chief measure of a bureau's success is the growth of its programs. As long as the budgetary growth of one program does not occur at the expense of the budgets of other programs, it is not in the interest of any bureaucracy to increase conflict through opposition. In fact, many critics see the bureaucracy as a major factor in the growth of government expenditures since increasingly ideas for new programs are developed within the government itself.

Other interest groups would not oppose the increased subsidy for the same reason as the bureaucracy--namely, as long as an increase in one area does not mean a decrease in another, there is little incentive for an uninvolved group to endure the conflict opposition would engender. In fact, many critics point to the growing number of organized interest groups as a major factor behind the increase of federal expenditures. Not only has the number of interest groups grown, but they have become increasingly organized and sophisticated in using modern public relations techniques to mobilize the beneficiaries of subsidies to apply pressure on elected officials.

Finally, say the critics, elected officials are placed in an increasingly difficult position. If they champion a cutback in outlays for any particular program, they encounter the strenuous opposition of the program's major beneficiaries. Frequently, this opposition takes the form of single-issue voting whereby those affected oppose the officials' reelections regardless of their actions on other issues. For their trouble, public officials will receive the lukewarm approval of taxpayers whose taxes may have been reduced a dollar or two per year.

Removal of Past Restraints

Until fairly recently, the bias of representative government toward expenditure growth and deficits was restrained by two important factors:

- The deeply held belief that budgets should be balanced, and
- The power of institutions such as the Presidency, the Office of Management and Budget (OMB), the Congressional leadership, and political parties, which traditionally acted as brakes against the pressures of special interests.

Balanced Budget Rule. For most of America's history, the most effective restraining force on the growth of expenditures and deficits was the moral rule that budgets should be balanced. During the last 40 years, however, for reasons ranging from new theories about the proper role of fiscal policy, to new views of

the proper role of the national government in guaranteeing such rights as a job, health care, education, and a minimum level of income, to simple political expendiency, the balanced budget rule has become less powerful. 2/

Budgeting is necessary to allocate limited resources. The advantage of the balanced budget rule is that it is relatively easy to understand and gives public officials a fairly specific notion of the amount of resources the government has to work with.

But this rule is also inflexible and much of the debate over proposed changes to the budget process involves disagreements of whether such inflexibility is or is not beneficial. While most economists see the flexibility of the current budget process as a virtue, many critics see it as a driving force behind expenditure growth and deficits.

When the balanced budget rule is relaxed so that the budget margin can be used to influence the economy, the amount of resources available to the government becomes a moving figure rather than some fixed amount. Both economic and budgetary critics of the present system attack the idea--widely accepted by most economists--that the budget is an appropriate tool of economic stabilization policy. On economic grounds, critics see discretionary fiscal policy as creating more economic problems than it solves. Most economists who favor a Constitutional amendment requiring a balanced budget do so, in part, because they believe that fiscal policy is destabilizing.

On budgetary or programmatic grounds, discretionary fiscal policy is seen as an escape valve that not only leads to increased deficits but also to expenditure growth. Concepts such as the full-employment budget are attacked on the grounds that, since economists cannot agree over time as to exactly what full employment is and since for structural reasons the economy rarely reaches full employment, deficits can be justified throughout

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2/ See, for example, James M. Buchanan and Richard E. Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes (New York: Academic Press, 1977); the essays in James M. Buchanan and Richard E. Wagner, eds., Fiscal Responsibility in Constitutional Democracy (Boston: Martinus Nijhoff, Social Science Division, 1978); and Herbert Stein, The Fiscal Revolution in America (University of Chicago Press, 1969).

economic cycles. 3/ Many economists counter that full-employment budgets are simply a means of measuring discretionary fiscal policy and as such, are mere yardsticks without political bias.

Declining Power of Institutions. In the past, institutions such as the Presidency, OMB, Congressional leadership, and political parties restrained budgetary growth by forcing competition among special interests. Public officials could fend off special interest pressure by saying that while they personally wanted to do X or Y they just couldn't because the President, OMB, their leadership, or their party would not let them.

Many observers believe that the power of each of these institutions has declined in recent years. The Vietnam War and Watergate severely undermined Presidential power. Some scholars perceive OMB as a shadow of the old Bureau of the Budget. Recent reforms have continued the dispersal of power within the Congress. Finally, the institution that many political scientists would point to as the most important bulwark against special interests--the political party--is experiencing severe difficulty. In recent years, party loyalty among voters and elected officials has declined dramatically. Split-ticket voting has risen to an all-time high and party voting in the Congress has declined to a 30-year low. Thus, each elected official is increasingly judged by the voters on his or her qualifications. While this is an admirable change in many respects, it does mean that each public official must face interest group pressures alone, a situation that many observers think has left officials increasingly susceptible to such pressures.

Statutory Versus Constitutional Prohibitions

Those who feel that the system bias is so strong as to overwhelm traditional budget reforms have turned to statutory and Constitutional prohibitions as solutions. All of the following options to prohibit deficits and limit expenditure growth can be implemented either through changes in law--primarily amendments to the Congressional Budget Act of 1974--or through amendments to the U.S. Constitution.

Which route is chosen depends on a judgment of the strength of the prohibition needed to overcome the pressures for expendi-

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3/ Aaron Wildavsky, How To Limit Government Spending (Berkeley: University of California, 1980).

ture growth and deficits. Statutory prohibitions could be overturned by working majorities of the House and Senate and Presidential agreement, or, in the case of a Presidential veto, by a two-thirds vote of each House. Constitutional prohibitions, on the other hand, could only be overturned through a new Constitutional amendment. Such action would require two-thirds votes of the House and the Senate and the agreement of three-quarters of the state legislatures.

The advantage of the statutory route, therefore, is that it would be relatively easy to modify if the prohibition should prove to be damaging to the economy or contrary to changing sentiments of the Congress and the public. 4/ Its disadvantage is that it might be so easy to modify as to be ineffective. Conversely, the advantage of a Constitutional amendment is that it would have a better chance of containing the pressures toward spending growth and deficits. But, once implemented, a Constitutional amendment would be less flexible to changing economic and political circumstances.

Requirement for Concurrent Majorities

As indicated at the beginning of this chapter, the American political system operates largely through simple majorities or pluralities, both at the ballot box and in the Congress. The U.S. Constitution requires a Congressional vote greater than a simple (concurrent) majority in only seven instances--expulsion of a Member, passage of vetoed bills, removal of political disabilities, amendments to the Constitution, Senate ratification of treaties, declaring the President unable to perform the duties of his office, and convicting an impeached federal officer. 5/ Of these, only the two-thirds vote required for ratification can in

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4/ Arthur F. Burns has recommended a statutory prohibition to test its workability. See Arthur F. Burns, "Statement on the Proposed Constitutional Requirement of a Balanced Budget," before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 96:1 (March 27, 1979).

5/ Concerning the removal of political disabilities, Section 3 of the Fourteenth Amendment to the U.S. Constitution states:

> No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the

any sense be said to be biased in a policy direction--that is, against foreign entanglements.

Most of the proposed Constitutional amendments to limit deficits or expenditure growth provide for overriding the amendment's prohibition in case of war or a national emergency declared by a super-majority, that is, a vote of three-fifths, two-thirds, or three-fourths of the total membership of each House. Most commentators have viewed these provisions as escape clauses. But they can also be viewed as a fundamental change in the rules of the game. The most important effect of the escape clauses is that they shift decisionmaking on budget questions from a simple majority of those voting to a two-thirds or three-fourths majority of the total membership.

It is difficult to predict the effect of such a shift. It is worth noting, however, that the House of Representatives has yet to pass a budget resolution by a two-thirds majority. If the voting requirement for passage of a budget deficit became more stringent, moreover, the probability that any given Member or group of Members could demand a specific legislative concession for their votes might increase.

Finally, it is also worth noting that under the options discussed below the United States could declare war--which takes a simple majority vote--much more easily than it could deliberately run a deficit or exceed certain growth rates in expenditures or revenues. The central question is whether the economic and social benefits of these prohibitions are worth such a fundamental change.

OPTIONS REQUIRING A BALANCED BUDGET

The various bills and Constitutional amendments that have been introduced to limit or prohibit federal budget deficits differ as to:

> United States, or under any State, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may, by a vote of two-thirds of each House, remove such disability.

- Who is responsible for achieving the balance and how the prohibition of deficits is to be enforced.
- What is prohibited--that is, under what conditions is the budget considered in deficit.
- Whether the balance must be achieved annually.
- What, if anything, is done about retiring the existing public debt.
- Whether a phasing procedure is included in the bill or Constitutional amendment.

Who Is Responsible for Balancing What?

Most of the proposed bills and amendments require the Congress to assure that the federal budget is balanced. Under current budgetary procedures, however, the Congress has limited control over the actual amount of federal expenditures and revenues that are spent and collected each year.

On the spending side, the Congress grants authority to the Executive Branch to enter into obligations. These obligations are commitments by the federal government to the prospective beneficiaries, and, when they have to be fulfilled, the Treasury makes the necessary payments. Thus, a large part of the actual amount of federal money spent each fiscal year is determined by Executive Branch actions on the authority granted by the Congress.

The Congress has also structured many federal programs so that their expenditures will be sensitive to the economy. Because approximately 40 percent of federal expenditures are adjusted automatically for increases in the price level, a 1 percentage point rise in the rate of inflation will increase federal outlays by as much as $2 billion. A similar relationship holds for increases in the unemployment rate, with a 1 percentage point rise leading to an additional $5 to $10 billion in automatic expenditures.

The Congress also has only indirect control over the amount of tax receipts; it controls tax rates, not levels of revenue. The actual level of revenues in a given year is even more sensitive to economic activity than are expenditures. A 1 percentage point increase in the inflation rate will bring in $5 to $15 billion in additional receipts, while a 1 percentage point rise in unemployment will result in a $20 billion decline in revenues.

How Often Is the Budget to Be Balanced?

Most of the proposals require balanced federal budgets every year. Some, however, aim for the achievement of budget balance over an economic cycle. One option, for example, would allow deficits brought on by changing economic circumstances as long as they were less than 2 percent of expenditures (or a $13 billion deficit in fiscal year 1981) and as long as any deficit was repaid over the next five years. 6/ Such a plan would be less likely to have a destabilizing economic effect than those proposals that would require annual balances.

It is important to remember, however, that a 1 percentage point rise in the unemployment rate would automatically increase the federal budget deficit by $25 billion the first year. This flexible option, therefore, would only allow for a half - percent rise in the unemployment rate before a two-thirds vote of the House and Senate would be required.

Illustrative Options

Option I--Make the Congress Responsible but Only Require that It "Seek to Assure" a Balanced Budget. This option, in effect, would establish the goal of balanced budgets as Congressional policy. While placing the responsibility with the Congress, the option would not prohibit a deficit.

Option II--Make the Congress Responsible and Require that Budget Estimates Be Balanced. One form of this option would prohibit outlays from exceeding revenues in budget resolutions. It would be similar to the 19th century balanced budget rule that planned expenditures should equal planned revenues. Under this option, deficits brought about by changing economic conditions would not be prohibited, but the Congress could not legislate planned deficits to stimulate the economy.

Option III--Make the Congress Responsible by Prohibiting Appropriations, Outlays, or Total Expenditures in Excess of Revenues, or by Prohibiting Any Action that Would Cause an Increase in the Public Debt. Although terms such as appropriations, outlays, expenditures, and public debt are what the Congress says they are, under current Congressional definitions the adoption of any of the

6/ H.J. Res. 181, introduced by Representative Fithian.

prohibitions in this option would not necessarily guarantee balanced budgets. For example, although the Congress can directly control the level of appropriations every year, such control would not eliminate deficits. Appropriations are one means of granting budget authority. Budget authority, however, is not always spent in the same fiscal year it is granted. Thus, under current practice the Congress enacts much more budget authority for each budget than ends up as outlays that year.

Outlays in excess of revenues is the standard definition of a budget deficit. The problem with a prohibition of outlays in excess of revenues is that the Congress does not directly control the level of either. In practice, therefore, a simple prohibition of outlays in excess of revenues would be the equivalent of Option II.

The term expenditures is frequently used in the proposed bills and amendments. According to the Comptroller General, the term expenditures has the same legal meaning as the term outlays. 7/ Those who have adopted the prohibition of total expenditures exceeding revenues have done so in order to try to control off-budget spending. Achievement of this goal, however, would require further legislation.

In order to comply with the requirement that the public debt not grow, either the budget would frequently have to be in surplus or the trust funds would have to be excluded from the unified budget. Currently, increases in the federal debt result from the combination of the unified budget deficit (if any), the off-budget deficit (if any), and the trust fund surplus (if any). The trust fund surplus is included because, by law, any surplus from most trust funds must be invested in federal securities. It is possible, therefore, to have a unified budget balance and an off-budget balance, but a rise in federal debt, because the trust funds are in surplus.

Option IV--Require the Congress to Achieve a Balanced Budget at the End of Each Fiscal Year. This option would require that periodically throughout the budget cycle and the fiscal year the Congress review estimates of expenditures and revenues and modify

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6/ The Comptroller General of the United States, A Glossary of Terms Used in the Federal Budget Process, third edition (General Accounting Office, March 1981), p. 58.

appropriations and/or tax rates to guarantee that a balanced budget is achieved at the end of the fiscal year. Most of the proposed bills and Constitutional amendments that follow this option incorporate a requirement that a surtax be imposed if it appears that expenditures would exceed revenues. This option is much more likely to have a destabilizing effect on the economy than those proposals that would only require a planned balance (Options I and II).

Option V--Require the Congress to Enact Budget Authority and Tax Rates to Achieve a Balance and Require the President to Ensure a Balance at the End of the Fiscal Year. This option would require that the President or some other official of the Executive Branch be empowered to impose a surtax or impound funds in order to guarantee a balanced budget. Because it would require an actual balance regardless of economic conditions, Option V would probably be destabilizing during some periods. This option also implies a significant shift of budgetary power from the Congress to the President.

OPTIONS FOR LIMITING EXPENDITURE AND REVENUE GROWTH

The proposals that have been introduced to check the growth of federal expenditures differ as to:

- Whether their aim is to maintain the current size of the public sector or to reduce it.
- Who is responsible for limiting growth and how the prevention of excess growth is to be enforced.
- What is included under the limit.
- The formula that is used to control growth.

Size of the Public Sector

The proposed expenditure and revenue limitation measures seek either to prevent increases in the federal sector and revenue burden or to reduce them gradually. Almost all of the suggested formulas can be modified to achieve either goal since they are based on arbitrarily chosen percentages.

Who Is Responsible, Who Enforces?

As with the balanced budget options, expenditure limitations differ as to both the stage of the budget cycle to which the limit is applied and what action is to be taken should expenditures or revenues exceed the formula's limit either through changes in the economy, incorrect budget estimates, or legislative or executive actions. Some of the proposals would simply require that the planned Congressional budget be within the limits while others would require the Congress and/or the President to reduce outlays either by cutting appropriations or by impounding funds if the actual expenditures would exceed the limit.

All of the expenditure formulas would limit the growth of outlays rather than appropriations or budget authority. This means that the Congress would be asked to limit a measure of spending over which it does not have direct control. Switching to formulas that use appropriations or budget authority would not help very much. Appropriations (other than for entitlements) account for only a portion (around 40 percent) of federal expenditures and a large portion of the budget authority in each year's budget is permanently granted.

What Is Included Under the Limit

Most of the proposals seeking to restrict the growth rate or level of federal outlays place a limit on total outlays (which include off-budget as well as unified budget outlays). The proponents' goal is to prevent future Congresses from excluding certain types of budget activity from the limit. Chapter VII discusses whether any Constitutional amendment could prevent the Congress from shifting federal activities from programs included in the unified budget to off-budget agencies, special provisions of the tax code (tax expenditures), federal credit programs, or federal regulations.

It should be noted, however, that several proposals have tried to anticipate some of the "end-runs" that might be tried to circumvent any expenditure limitation. In the 96th Congress, for example, then House Budget Committee Chairman Robert Giaimo introduced H.R. 6021 which would have placed a limit on the total of federal outlays and tax expenditures. In the 97th Congress, H.J. Res. 350 and H.J. Res. 169 would attempt to prevent the Congress from shifting current federal programs to the states by requiring the Congress to provide compensation equal to the costs

to the states of additional activities mandated by the federal government. 8/

Rather than establishing as inclusive a limit as possible, some critics of expenditure limitations contend that some truly uncontrollable parts of the federal budget should be excluded from any limit. Robert Hartman, for example, has suggested that any enacted limit be placed on federal outlays less net interest on the public debt. 9/ Hartman argues that, if the object of an expenditure limit is to control the size of public activities or programs, including net interest on the public debt under the limit would result in a misleading notion of the size of the government when the inflation rate varies. For example, in fiscal year 1976 total federal budget outlays equalled 22.2 percent of GNP. By fiscal year 1981 this ratio had increased to 23.0 percent of GNP. This growth, however, was caused totally by the higher cost of borrowing money; outlays minus net interest remained at 20.6 percent of GNP. Federal government activities just kept pace with GNP during this period.

If one believes that the cost of federal borrowing is beyond the control of the Congress, it would make sense to exclude net interest from any limit. Those who advocate expenditure limits, however, argue that the increased cost of money in recent years at least partly results from federal fiscal policy. Moreover, they contend that a major goal of their proposals is to reduce the amount of federal outlays regardless of their controllability. Therefore, if forces beyond the control of the Congress led to an increase in interest payments, the Congress should reduce other programs, raise additional revenues (in the case of a proposal that prohibits deficits), or, by achieving the necessary super-majorities, invoke the escape clause to allow expenditures to exceed the limit. The advocates of limits also point out that the federal government could follow state practices and develop a contingency fund for just such emergencies.

8/ It should be noted that such a provision would imply a significant shift of power from the national government to the states.

9/ Statement by Robert W. Hartman, Senior Fellow, the Brookings Institution, before the Senate Budget Committee Field Hearings on S. 1848, Seattle, Washington, June 4, 1982.

Illustrative Options

All of the expenditure limitation proposals include a formula to determine maximum allowable federal budget outlays for a given year. 10/ Any formula type can be adjusted so as either to stabilize or to reduce the size of the federal sector. Although some of the formulas appear to be quite complex, they can be grouped into the following four options.

Option I--Set a Fixed Maximum Percentage Rate of Growth for Federal Outlays. Depending on the inflation rate, this type of formula could either dramatically reduce the size of the federal sector or provide no effective limitation at all. For example, a maximum 10 percent outlay growth rate would greatly reduce the size of the federal sector in an era of 15 percent inflation while providing considerable leeway for growth in a period of 3 percent inflation.

Option II--Limit Federal Outlays to a Fixed Percentage of an Economic Indicator (for example, GNP, national income, or potential GNP). A major advantage of this class of formulas is that their structure closely corresponds to their goal. That is, since the goal is to limit the federal sector to a proportion of the economy, this type of option uses a percentage of a measure of that economy.

All of the formulas in this group contain measurement problems in that they involve the use of outlay totals and economic statistics that are not complete at the time the Congress makes budgetary decisions. For example, when CBO forecasts the gross national product, it presents its estimate as a range. That range is plus or minus 4 percent around its midpoint. Depending on which end of the range was used, a limit based on a proportion of GNP would span a $30 billion range. 11/

10/ Most of the proposals also include an escape clause that would allow outlays to exceed the limit with a three-fifths, two-thirds, or three-fourths vote of the total membership of the House and Senate.

11/ For example, in its markup of the First Concurrent Resolution on the Budget for Fiscal Year 1981, the Senate Budget Committee took two roll call votes to determine which GNP figure would be used to comply with the S. Res. 380 requirement that

To overcome this difficulty, some of the formulas use economic indicators from previous years. This, in turn, leads to the potential difficulty of selecting an indicator from one part of an economic cycle (for example, an expansion) and applying it to the federal budget during another part (a recession). 12/ Two approaches have been suggested to overcome this problem: the use of a multiyear average of the economic indicators or the use of potential GNP. Both alternatives have the advantage of creating an economic indicator that is not dramatically affected by economic cycles.

Option III--Limit the Growth Rate of Federal Outlays to the Growth Rate of an Economic Indicator. In addition to the measurement problems that are associated with the formulas of Option II, this class could cause two additional problems. First, an incentive would be created for the Congress and the bureaucracy to spend to the previous year's limit.

Second, this type of option could cause a downward bias in the limit over time. If these proposals operate as expected by their sponsors, they would create a new set of political and bureaucratic incentives. In contrast to the current system, which is characterized by the routine adoption of fairly optimistic forecasts of revenues and outlays, these proposals, according to their sponsors, would cause federal budgeting to resemble state and local budgeting in which budget officers tend to adopt conservative estimates of revenues and outlays because of constitutional limits. On the state and local level, this tends to lead to routine surpluses, except during severe recessions.

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it report out an alternative resolution with outlays equaling 21 percent of GNP. Because the higher GNP figure was accepted by the committee, outlays in the alternative budget had to be reduced an additional $10.8 billion to meet the 21 percent of GNP requirement. See First Concurrent Resolution on the Budget, FY 1981, Report No. 96-654, Senate Committee on the Budget, to accompany S. Con. Res. 86, 96:1 (1980), p. 335.

12/ The use of economic indicators from previous years can also have unintended effects during periods of rapidly changing inflation rates since the impact of inflation will be reflected in the economic indicator before it is reflected in budget outlays.

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If these new incentives are created and federal budget planning shifts so that actual outlays tend to be lower than planned outlays, the base on which the following year's limit is produced would be smaller than if actual outlays had hit the limit. Such a continual pattern, over time, would lead to a gradual reduction in the relative size of the federal sector.

Option IV--One of the Above Options Plus a Provision to Reduce the Maximum Rate of Growth Unless the Federal Government Achieves a Certain Inflation Rate. 13/ This option rests on the assumption that the federal government could achieve an inflation rate target if it only wanted to or on the premise that the federal sector should decline over time. These proposals set a target rate for inflation and then penalize growth in spending when the target is exceeded. One problem with this option is that, if the target rate for inflation is below the attainable rate, the formula would continually reduce the relative size of the federal sector while, if the target is set too high, it might become the inflation goal. In any event, a reasonable target would be hard to determine and harder to change.

H.J. RES. 350 AND S.J. RES. 58: COMBINING DEFICIT RESTRICTIONS AND EXPENDITURE AND REVENUE LIMITATIONS

On August 4, 1982 the Senate passed S.J. Res. 58 by a roll call vote of 69 in favor to 31 against. This proposed constitutional amendment would restrain federal deficits and increases in the public debt and limit the growth of federal revenues and outlays. H.J. Res. 350--a similar proposal with some key differences--is now being considered by the House Judiciary Committee. This section discusses these two major proposals that are now before the Congress.

Provisions Restraining Deficits and Increases in the Public Debt

Both S.J. Res. 58 and H.J. Res. 350 would require the Congress to enact a planned budget prior to each fiscal year in which

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13/ For example, H.J. Res. 169, introduced by Representative Jenkins and supported by a subcommittee headed by Milton Friedman of the National Tax Limitation Committee, uses a growth rate formula that would be lowered by one-fourth of a percentage point for every percentage point that the inflation rate in the most recently completed calendar year was over 3 percent.

total planned outlays did not exceed total planned revenues. Both resolutions also set growth limits on revenues based on growth in national income and require that actual outlays not exceed planned outlays. The most important difference between the two resolutions is that S.J. Res. 58 would also require the Congress to ensure that actual total outlays did not exceed actual total revenues by making it extremely difficult to raise the public debt limit to accommodate deficits.

As approved by the Senate Judiciary Committee, S.J. Res. 58 was identical to H.J. Res. 350. The requirement for an actual as well as a planned balance was introduced through a floor amendment by Senators Armstrong and Boren. Under this amendment, the public debt could be increased only through enactment of a bill by at least a three-fifths vote (60 percent) of the whole membership of each House. The original intent of S.J. Res. 58 (and the current intent of H.J. Res. 350) was to establish the norm of a balanced budget by requiring the Congress to plan a balanced budget each year unless the country was under a declaration of war or unless each House chose to enact a planned deficit by a three-fifths vote of their whole memberships. The authors attempted to avoid situations in which the proposals would cause fiscal changes that would be procyclical to changes in the economy. As reported by the Senate Judiciary Committee, S.J. Res. 58 (and the current version of H.J. Res. 350) would allow actual revenues to fall below planned revenues, resulting in an unplanned deficit, should an unanticipated recession occur once the fiscal year began.

When the Senate adopted the Armstrong-Boren amendment, it precluded unanticipated deficits in almost all circumstances. Thus, S.J. Res. 58, as passed by the Senate, would have a much more dramatic effect on the economy than the version of S.J. Res. 58 that was approved by the Senate Judiciary Committee or H.J. Res. 350. Unless the 60 percent vote could be obtained in each House, the Congress would be forced either to reduce expenditures or to raise taxes during recessions. In fact, because of the current statutory requirement that trust fund surpluses be invested in federal securities, under some circumstances the Senate-passed version of S.J. Res. 58 could require three-fifths vote in each House even when the budget is balanced, since such trust fund investments are currently counted as increases in the public debt.

Revenue and Expenditure Limitations

Both S.J. Res. 58 and H.J. Res. 350 would seek to limit the growth of total budget outlays by placing a limit on the growth of

total planned revenues in their required planned budget and by requiring that total planned outlays in that budget not exceed the total planned revenues. Both resolutions then would require that the Congress and the President ensure that total actual outlays at the end of the fiscal year not exceed the total planned outlays.

The formula that controls the growth in planned revenues is different in the Senate passed version of S.J. Res. 58 from that in H.J. Res. 350. Under H.J. Res. 350, planned revenues for the upcoming fiscal year could not grow from the revenue base of the current fiscal year at a faster rate than national income grew in the most recently completed calendar year. For example, to determine the revenue limit for fiscal year 1984, the Congress would apply the growth rate of current dollar GNP (a common measure of national income) between calendar years 1981 and 1982 to the current estimate for total revenues for fiscal year 1983.

When it considered S.J. Res. 58, the Senate accepted an amendment by Senators Domenici and Chiles that would modify this formula. This amendment had three major provisions. First, rather than using the growth rate of current dollar national income in the most recently completed calendar year, the Domenici-Chiles amendment substitutes the growth rate of national income "in the year or years ending not less than six months nor more than twelve months" before the fiscal year that is being considered in the planned budget. Second, the Domenici-Chiles amendment inserted a new section requiring the Congress to enforce and implement the other provisions of S.J. Res. 58 through appropriate legislation.

These changes could have two possible effects. First, by substituting a time period for the most recently completed calendar year the Domenici-Chiles amendment created the flexiblity that would be needed should the Congress choose to alter the timing of the fiscal year. More important, by including the words "year or years" and by giving the Congress flexibility to develop implementation statutes, the Domenici-Chiles amendment opens the possibility that the Congress could change the revenue limitation formula through the enactment of a statute. For example, instead of a one-year lagged growth rate, the Congress could enact a statute that uses the average growth rates of the last five fiscal years. The amendment would also allow the Congress to choose what type of year--fiscal, calendar, or some newly defined accounting period--to use in the formula. Thus, although S.J. Res. 58 as enacted by the Senate and H.J. Res. 350 are both examples of expenditure limitation Option III, the specifics of their limitation formulas could vary.

As with the other proposals under expenditure limitation Option III, S.J. Res. 58 and H.J. Res. 350 would attempt to overcome estimating problems by adopting a limit on revenue growth based on data from a completed prior year. Because that growth rate is applied to a revenue base of a fiscal year that is still under way, however, estimation problems are not totally avoided. Assuming that the planned budget would be developed in the spring of each calendar year, the fiscal year that would be used to determine the revenue base would be only half over. Because of the sensitivity of revenues to economic assumptions--a given change in real growth leads to four times the dollar change in revenues as compared to outlays--the Congress could use different assumptions in order to increase the size of the revenue--and thus the outlay--limit in the planned budget.

The revenue limit, and thus the outlay limit, of both proposals could be raised by legislation enacted by a majority of the whole number of each House and signed by the President. Thus, S.J. Res. 58 and H.J. Res. 350 would allow majorities (albeit majorities of the whole number of Congressmen and Senators rather than a majority of those present and voting) to increase the size of the public sector. The majority of the Congress would have to go on record in order to increase the size of the federal sector. Moreover, the Congress might have to vote to increase taxes to accomplish this.

The framers of S.J. Res. 58 and H.J. Res. 350 apparently intended the separate vote to raise taxes above the limit to serve another purpose, namely, to prevent the tax increases that occur when inflation pushes taxpayers into higher marginal tax brackets. Since these proposals were introduced, however, the individual income tax has been indexed (effective in 1985) to the inflation rate to eliminate "bracket creep."

S.J. Res. 58 and H.J. Res. 350 also would require that a law be enacted to allow the federal government to collect receipts above the revenue limit even when the tax code needed no change. For example, under the formula of H.J. Res. 350, if the estimate of receipts, based on the existing tax code, in the planned budget was greater than the limit on receipts, the Congress either would have to pass a bill to collect the additional receipts or would have to reduce tax rates and, perhaps, make necessary adjustments in planned outlays. If the bill to collect additional receipts were vetoed by the President, and not overridden, it is not clear what would happen next.

The third change in S.J. Res. 58 brought about by the Domenici-Chiles amendment was to require that the Congress and the President ensure that actual outlays not exceed planned outlays through legislation. H.J. Res. 350 simply requires that the Congress and the President ensure that actual outlays not exceed planned outlays. The Domenici-Chiles amendment sought to make it impossible for a President to use this requirement as a justification for expanding his impoundment powers; whether it succeeded ultimately would be for the Supreme Court to decide.

Other Provisions

The final difference between S.J. Res. 58 and H.J. Res. 350 is that the latter proposal still contains a section, which was removed from S.J. Res. 58 on the Senate floor, that "Congress may not require that the States engage in additional activities without compensation equal to the additional costs." This provision was included in the original version of S.J. Res. 58 and in H.J. Res. 350 in order to prevent the Congress from circumventing the intent of the federal sector limitation by shifting responsibilities to other government levels. The Senate chose to drop the section because it felt that the requirement could imply a shift of Constitutional responsibilities from the federal government to the states and could lead to a great amount of litigation.

S.J. Res. 58 and H.J. Res. 350 both contain language defining total revenues--"all receipts of the United States except those derived from borrowing"--and total outlays--"all outlays of the United States except those for the repayment of debt principal." These definitions were included to prevent future Congresses from avoiding the scope of the amendments by shifting programs to off-budget status. Chapter VII discusses whether these definitions can succeed in their purpose.

Finally, both proposals incorporate a two-year implementation period so that the move from the current regime of large deficits to one of planned balances (in the case of H.J. Res. 350) and actual balances (in the case of S.J. Res. 58) could be accomplished without dramatic shifts in budget policy in a single year. Whether a two-year phase-in is enough time to implement these proposals smoothly is discussed in the next chapter.

CHAPTER V. THE EFFECTS OF ANNUALLY BALANCED BUDGETS ON THE ECONOMY AND THE SIZE OF THE FEDERAL SECTOR

Even if the Congress enacts all the proposed expenditure reductions and tax increases called for in the first concurrent resolution for fiscal year 1983, the federal budget probably will run deficits in excess of $150 billion for the next several years. 1/ Thus, the implementation of a balanced budget rule in the near future would require large additional expenditure reductions, large additional tax increases, or both. This is likely to cause severe short-run disruptions in the economy. The first section of this chapter discusses these short-term effects.

Once implemented, however, the effect of a balanced budget rule over the long run is much more difficult to assess since it would bring about such a fundamental change in the institutional relationships by which the federal government tries to moderate economic cycles. Recent economic history, however, can be used to highlight both the potential gains to fiscal policy from having a balanced budget rule (essentially the prevention of fiscal policy errors) and the potential losses (impaired ability to stabilize a declining economy). This is done in the second part of this chapter.

SHORT-RUN EFFECTS ON THE ECONOMY AND THE FEDERAL SECTOR

Serious problems for the nation's economy would arise in the transition from the current deficit budget to the regime of S.J. Res. 58 and H.J. Res. 350. If implemented in fiscal year 1985 (which would require ratification by the states before October 1983), these resolutions would sharply accelerate the trend toward reducing fiscal stimulus that has begun with recent Congressional actions on the fiscal year 1983 budget. 2/

1/ See CBO, The Economic and Budget Outlook: An Update (September 1982).

2/ The Omnibus Reconciliation Act of 1982 (H.R. 6955) and The Tax Equity and Fiscal Responsibility Act of 1982 (H.R. 496).

TABLE 5. PROJECTED FEDERAL DEFICITS (By fiscal year, in billions of dollars)

	1983	1984	1985
April Baseline Projections			
Unified budget deficit	182	216	233
Off-budget spending	21	21	20
Total deficit	203	237	253
First Concurrent Resolution on the Budget for 1983			
Unified budget deficit	104	84	60
Off-budget spending	21	21	20
Total deficit	125	105	80
Budget Resolution Updated by CBO September 1982 Reestimates			
Unified budget deficit	155	152	152
Off-budget spending	18	18	18
Total deficit	173	170	170

CBO's current policy baseline budget projections of April 1982, showed that, even assuming a moderate economic recovery for fiscal years 1983 to 1985, the projected budget deficits would be large and would increase from year to year (see Table 5). (The deficit totals in Table 5 include the outlays of off-budget entities because the proposed amendment requires that they be counted.) By 1985, the total deficit was projected to exceed $250 billion, or 6 percent of GNP. Virtually no economic theory could support a governmental financial structure that showed such high deficits as the economy progressed to a more prosperous state.

As a consequence, the First Concurrent Resolution on the Budget for Fiscal Year 1983 instructed the committees of both Houses to bring forward legislation to raise taxes and lower spending over the period of fiscal years 1983-1985. Projections of the budget under the assumptions of the first concurrent resolution show a substantial reduction in deficits and the elimination of the widening pattern over time.

Since the enactment of the resolution, however, CBO's September 1982 forecast shows that, when the budget estimates are updated to take into account the severity of the current recession (together with small downward revisions in projections of real economic growth and inflation), deficits by 1985 could swell to the range of $152 billion on a unified budget basis and to $170 billion including the off-budget deficits. The September 1982 CBO update incorporates the effects of the 1982 reconciliation and tax acts. This indicates that attaining budget balance by the mid-1980s will be much more difficult than previously thought.

If S.J. Res. 58 and H.J. Res. 350 were ratified by the states before October 1983, their provisions would become effective for fiscal year 1985. This would mean that revenues in 1985 could not exceed an amount derived by applying the growth rate in national income for calendar year 1983 to fiscal year 1984 revenues (unless a specific bill providing for greater revenues was passed by a majority of the whole membership of both Houses). The revenue ceiling would also become the limit on total outlays--including outlays of off-budget entities--under the provision forbidding a planned deficit.

The budgetary and economic implications of these provisions would be severe. The amendment would leave the Congress with two alternatives in the next two years: to cut spending abruptly below the level projected in the first concurrent resolution; and/or to raise taxes sharply above the amounts projected in that concurrent resolution. If the Congress failed to take either action, it would be forced to waive the provisions of the amendment in its first year of implementation. This could be done only by a three-fifths vote of the whole membership of both Houses. Specifically, if CBO's current forecast is accurate, the amendment would require additional spending cuts and tax increases (over and above the cuts and tax increases legislated in 1982) that together would add up to $170 billion, or over 4 percent of GNP.

Impact on the Economy

The effect on the economy of such a shift in taxing and spending in fiscal year 1985 could be severe. The initial reduction in incomes of taxpayers, or of entitlement recipients, or of firms selling goods and services to the government would set off a chain of declining purchases, reductions in output, and job-cutting. This shock would come at a time of nearly 8 percent unemployment, according to CBO's forecast. If the Congress tried to

anticipate the problem by partially implementing the tax increases and spending cuts in fiscal year 1984, the changes would begin at a time when the recovery was even younger and the unemployment rate was even higher.

The effects of such a huge reduction in fiscal stimulus on real growth and unemployment could be offset only if real interest rates were to fall sharply and if interest-sensitive sectors of the economy such as housing, were to rebound rapidly. The problem with this scenario for the near future is that CBO's projections of the budget already assume a substantial decline in real interest rates. For example, the three-month Treasury bill rate, corrected for underlying inflation, averaged about 6-1/2 percent in the first half of 1982. CBO now expects it to decline to about half that rate by 1985. A sharp reduction in fiscal stimulus in 1984 and 1985 would put very heavy pressure on the Federal Reserve to bring interest rates down even more, but there might be limits on its ability or willingness to respond. Even if real interest rates did come down, $170 billion in reduced fiscal stimulus would have to be replaced by increased economic activity in the consumer durable, housing, and plant and equipment sectors. While it is not impossible for these sectors to expand so rapidly, the pace of the expansion that would be needed to fill the gap seems overly optimistic.

In short, implementation of the first concurrent resolution already implies significant progress toward correcting the unhealthy budget outlook projected earlier this year. Even if these budget actions brought down real interest rates and strengthened the expected economic recovery, further action along these lines would probably be necessary. It is extremely unlikely, however, that a reduction in fiscal stimulus sufficient to balance the budget as early as fiscal years 1984 and 1985 would be consistent with continued economic recovery.

Impact on the Federal Sector

Cutting an additional $170 billion from the fiscal year 1985 total deficit would be a very difficult task. If a large part of it was done on the spending side of the budget, major dislocations in existing programs would result. As shown in Table 6, under the assumptions of the first budget resolution, by 1985 national defense spending (excluding military retirement benefits) would be about 29 percent of budget outlays, pensions and Medicare would be about 35 percent, and net interest would account for 13 percent. If spending cuts were concentrated in the remaining portion

TABLE 6. COMPOSITION OF FEDERAL OUTLAYS (By fiscal year)

	Actual 1980	Projection 1985	Change
	Billions of dollars		
National Defense (except military retirement)	124	262	138
Pensions and Medicare a/	182	315	133
Other Entitlements	87	112	25
Nondefense Discretionary	140	138	-2
Net Interest	52	118	66
Other Spending	13	9	-4
Offsetting Receipts b/	-22	-44	-22
United Budget Outlays	577	910	333
Off-Budget Federal Entities	14	18	4
Total Outlays	591	928	337
	Percent of Unified Budget Outlays		
National Defense (except military retirement)	21	29	8
Pensions and Medicare a/	32	35	3
Other Entitlements	15	12	-3
Nondefense Discretionary	24	15	-9
Net Interest	9	13	4
Other Spending	2	1	-1
Offsetting Receipts b/	-4	-5	-1
Unified Budget Outlays	100	100	0

NOTE: Details may not add to totals because of rounding.

a/ Old-Age and Survivors Insurance, Disability Insurance, Railroad Retirement, Black Lung, Federal Employee Retirement and Disability, Hospital Insurance, and Supplementary Medical Insurance.

b/ Proprietary receipts from the public and employer share, employee retirement.

of the budget, over half of it would be eliminated. Outlays for other entitlements, nondefense discretionary programs and off-budget spending are projected to total about $270 billion in 1985. This part of the budget is made up of grants to state and local governments, farm price supports, research, pay in civilian agencies, and the means-tested programs such as food stamps and Medicaid. This is the portion of the budget already hardest hit by the budget resolutions of the last two years. It is likely, therefore, that budget cuts of the magnitude implied by the application of S.J. Res. 58 and H.J. Res. 350 would have to be made in large part in the national defense and pensions categories. Such reductions, in all likelihood, would result in lost benefits to current beneficiaries, elimination of all cost-of-living adjustments, and triggering of penalty payments to government contractors. Abrupt huge cuts in grants to states would prompt emergency state tax hikes and blunt caps on entitlements that could create inefficiencies and inequities that would have to be reversed later. In short, aside from the effect on the economy, an abrupt reduction in federal spending will lead to widespread inefficiencies. A similar case could be made against moving too abruptly in raising taxes to balance the budget. Almost all tax bills have phased-in tax changes over a period of years to avoid suddenly disrupting business and consumer plans.

LONG-RUN EFFECTS ON THE ECONOMY

Judging from history, neither unconstrained Congressional discretion in budgeting nor the proposed constraint of a balanced budget rule is an ideal alternative. Under existing procedures, the Congress can choose any type of fiscal policy. This Congressional flexibility has sometimes resulted in budgets that have been less than successful at achieving economic stability and growth than if they had been balanced. At other times, the Congress has chosen budgets that have been more successful than would have been the case with balanced budgets. The adoption of a balanced budget rule would be a decision to forego the more successful budgets in order to preempt less successful ones. A consideration in that decision, to which this section is addressed, is how a balanced budget rule would have affected the economy in the past and how it would affect it in the future.

Successful Budgets and the Conventional View of the Economy

Classifying budgets as more or less successful than mandated balanced ones requires a basis for evaluation. Conventional mac-

roeconomics provides an evaluative framework that can be summarized in three statements: one about the nature of the economy, another about the relationship between the budget and the economy, and a third that uses the first two to define successful budgets.

Nature of the Economy. A market economy does not constantly maintain high levels of employment and output or stable prices. Waves of consumer and investor optimism and pessimism, immoderate weather, supply interruptions from abroad, and labor unrest, among other causes, can subject the economy to a series of disturbances. With imperfect markets, which are often characterized by long-term commitments such as labor contracts, these disturbances can lead to fluctuations in output and employment, as well as prices.

Relationship of the Budget and the Economy. The federal budget and the economy affect each other. When the economy slides into recession, the budget is affected by a decline in tax revenues (because of lower incomes), an increase in outlays (for income maintenance programs, such as unemployment compensation), and a bigger deficit (because revenues are lower and outlays are higher). But that is not the end of the story. By cutting taxes and increasing spending, the government can, in time, induce individuals and firms to raise their levels of spending and thereby counter the economy's recessionary tendency. Similarly, an inflationary boom raises tax revenues more than government spending and reduces the federal deficit (or increases the surplus). By raising taxes and cutting expenditures, the government can--after a lag--reduce the level of private spending and temper the runaway pace of economic activity.

Successful and Unsuccessful Budgets. A goal of fiscal policy is to dampen business cycles through the effect of the budget on the economy. When the budget is being pulled into deficit by a recession, a deficit is better than a balanced budget because the deficit will moderate the recession. When a booming, inflationary economy is moving the budget into substantial surplus, a surplus is more conducive to economic stability than a balanced budget. From a conventional economic statilization perspective, budget policies that increase the deficit during high employment and decrease the deficit during recession would be worse, however, than annually balanced budgets.

Successful and Unsuccessful Budgets in Recent Experience

Some of the recent stabilization successes and failures of fiscal policy have been identified in a study by the staff of the

Joint Economic Committee, in collaboration with Wharton Econometric Forecasting Associates. 3/ That study asked: What would have happened to the economy if an annually balanced budget policy had been followed over the period 1965-1974? 4/ The historical interval is divided into three subperiods: third quarter of 1965 to second quarter of 1969; third quarter of 1969 to second quarter of 1972; and third quarter of 1972 to second quarter of 1974. The first two subperiods, discussed below, are especially illustrative of some of the economic stability gains and losses arising from a balanced budget rule.

Balanced Budgets During High Employment, 1966-1969. As can be seen in lines 1 and 2 of Table 7, this period was marked by rapidly increasing deficits that contributed to a decline in the unemployment rate to levels not reached since the early 1950s. This excessive fiscal stimulus contributed to the doubling of the rate of increase of the Consumer Price Index (CPI) between 1965 and 1969. The increase in the CPI of 6.1 percent for the year ending in December 1969 was the highest in 20 years.

This stimulative policy was reversed late in the period. An income tax surcharge was adopted in June 1968 and the Federal Reserve sharply tightened monetary policy during 1969 in an attempt to slow down the boom. The result was the recession of 1969-1970.

During 1966-1969, a balanced budget would have been more consistent with economic stability than the budgets actually adopted. Line 3 of Table 7 shows the Wharton Model's estimate of the unemployment path that would have resulted from balancing the budget by reducing federal purchases in 1966-68 and by increasing them in 1969 (to eliminate the surplus in that year). Line 4 shows the

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3/ Congressional Joint Economic Committee, The Economic Impact of Alternative Fiscal Policies, Studies in Fiscal Policy, 1, August 16, 1976.

4/ Two other policy options were also evaluated: balancing the full-employment budget and a variable discretionary policy based on changes "which economists might have regarded as reasonable at the time." The study found that, because the full-employment budget was actually close to balance over the period, a policy of full-employment balance would not have made much difference. The discretionary policy was found to have been "significantly better" than the policy actually pursued in some cases.

TABLE 7. FEDERAL BUDGET DEFICITS AND UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), FISCAL YEARS 1966-1969

	1966	1967	1968	1969
Deficit (in billions of dollars)	3.8	8.7	25.1	+3.2 (surplus)
Unemployment Rate (in percents)				
Actual	4.1	3.8	3.8	3.4
With budget balance through changes in federal purchases a/	4.1	5.2	6.7	4.1
With budget balance through changes in federal taxes	4.1	3.9	4.3	4.1
Inflation Rate (GNP deflator, in percents)				
Actual	3.1	3.0	4.2	4.8
With budget balance through changes in federal purchases a/	3.2	3.2	4.3	4.1
With budget balance through changes in federal taxes	3.2	3.2	4.4	4.5

SOURCE: Wharton Econometric Forecasting Associates.

a/ Federal spending is classified into two categories: transfers and the purchase of goods and services. This simulation achieves budget balance without changing transfers (essentially payments to individuals).

estimated effect on unemployment of achieving budget balance through tax changes. Both approaches to budget balance would have significantly limited the decline in the unemployment rate. A balanced budget rule would have avoided excessive fiscal stimulus and restrained the rate of inflation, thus permitting the adoption of more moderately restrictive policies in 1968-1969. 5/ The 1969-1970 slowdown could, therefore, have been milder or avoided altogether.

5/ The Wharton simulations show only a modest improvement in inflation with a tax-adjusted balanced budget: 4.5 percent in 1969 versus the actual 4.8 percent. However, a property of

Another notable feature of the JEC study is the suggestion that balancing the budget through changes in taxes (and transfers --not shown here) would have less effect on unemployment and inflation than doing so through variations in federal purchases.

Balanced Budgets During Recession and Recovery, 1970-1972. Implementing a balanced budget rule in fiscal year 1971 and adhering to it in 1972 would have substantially increased unemployment. Even if the numbers in lines 3 and 4 of Table 8 are overestimates, it is clear that the need to raise taxes and reduce expenditures to balance the budget during a recession would have worsened the recession and, in this simulation, done so without lowering the inflation rate.

Proponents of a balanced budget rule would protest that, if such a rule had been in force during 1966-1969, there need not have been a recession in 1969-1970 or a rise in unemployment in 1971-1972. One can agree that it is unfair to ask what the consequences of a balanced budget would be in circumstances that would have been much different with continuously balanced budgets. But one must also recognize instances when the attempt to force tax revenues to equal outlays would magnify economic disturbances.

A Balanced Budget in 1974-1977 (DRI Estimates). One of those occasions when a balanced budget rule clearly would have magnified an economic disturbance occurred after the shocks to the economy from the OPEC oil embargo and price increases and worldwide crop failures in late 1973. Estimates of the effect of annually balanced budgets on unemployment, according to one version of the Data Resources Inc. (DRI) model, are shown in Table 9. As can be seen, a balanced budget rule is estimated to increase the unemployment rate by over 2.5 percentage points in both 1975 and 1976. In addition, the recovery would have been delayed a year.

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the Wharton model used in this simulation is that one of the principal effects of a decline in aggregate demand is to lower labor productivity and raise prices. This property is not shared by most other large models. On average, these other models indicate that a 1 1/4 percentage point higher unemployment rate for three years (roughly corresponding to the purchases balance option) would reduce inflation by about 2 percentage points by the end of the period--or to 2 3/4 percent by 1969.

TABLE 8. FEDERAL BUDGET DEFICITS AND UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), FISCAL YEARS 1970-1972

	1970	1971	1972
Deficit (in billions of dollars)	2.8	23.0	23.4
Unemployment Rate (in percents)			
Actual	4.0	5.7	5.9
With budget balance through changes in federal purchases a/	4.0	8.5	9.7
With budget balance through changes in federal taxes	4.0	6.1	6.9
Inflation Rate (GNP deflator, in percents)			
Actual	5.1	4.6	3.1
With budget balance through changes in federal purchases a/	4.0	8.5 b/	9.7 b/
With budget balance through changes in federal taxes	5.2	5.5	4.0

SOURCE: Wharton Econometric Forecasting Associates.

a/ Federal spending is classified into two categories: transfers and the purchase of goods and services. This simulation achieves budget balance without changing transfers (essentially payments to individuals).

b/ These inflation impact estimates are implausible. See footnote 3.

The price effects of such a policy would have been salutary, however. With annually balanced budgets beginning in 1972, the rate of inflation, as measured by the GNP deflator, would have been below 4 percent in 1977, according to DRI estimates, rather than the actual 5.9 percent increase.

Bias in Unconstrained Budgeting

Advocates of a balanced budget rule do not base their case exclusively on the demonstration that, in some particular histori-

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TABLE 9. UNEMPLOYMENT AND INFLATION RATES (ACTUAL AND SIMULATED), CALENDAR YEARS 1974-1977

	1974	1975	1976	1977
Unemployment (in percents)				
Actual	5.6	8.5	7.7	7.0
Simulated with balanced budget	6.0	11.2	11.3	9.1
Inflation Rate (GNP Deflator, in percents)				
Actual	9.7	9.6	5.2	5.9
Simulated with balanced budget	9.0	8.6	2.5	3.3

SOURCE: Data Resources, Inc.

cal circumstances, a balanced budget would have been more consistent with economic stability than the budget actually adopted. They argue, more generally, that the politics of an unconstrained budget process is biased toward deficits and excessive fiscal stimulus. 6/ Of the 26 federal budgets since 1957, 24 have been in deficit (the $0.3 billion surplus in 1960 and the $3.2 billion surplus in 1969 were the exceptions). Senators and Representatives find it in their interest and in the interests of their constituencies to "vote for every appropriation, for every tax cut, and against every tax." 7/ These fiscally expansive pressures can be all the more intense just prior to national elections. 8/ The 1982 record of the Congress in raising taxes and lowering spending demonstrates, however, that fiscal tightening is not impossible even in an election year.

6/ J.M. Buchanan and R.E. Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes (New York: Academic Press, 1977).

7/ Senator Russell Long, Congressional Record, April 28, 1977, S6676.

8/ Edmund R. Tufte, Political Control of the Economy (Princeton University Press, 1978).

Effects of Persistent Deficits

Persistent deficits are thought to have adverse consequences for inflation, unemployment, productivity (output per unit of labor input), and the size of the federal budget.

Deficits, Inflation, and Unemployment. Deficits raise the level of aggregate demand above what it would be with balanced budgets; consequently, unemployment is lower for a period of time but inflation is higher. One of the difficulties of choosing to trade higher inflation for lower unemployment is that the beneficial effects on employment from fiscal stimulus are much shorter-lived than the effects on inflation. 9/ Thus, over time, as this trade-off is continued, the beneficial effects on employment dissipate while inflation continues to rise. The inflation effects of deficits, moreover, are especially pronounced if accompanied by an increase in the money supply. 10/

Deficits and Productivity. If persistent deficits raise real interest rates and thereby reduce the rate of investment, they can slow down the rate of growth of output per worker. Actually, deficits have two distinct, potentially offsetting effects on investment. First, by absorbing private savings, deficits leave fewer and more costly funds, at any given income level, for productivity-enhancing investments. In this way, Treasury borrowing to

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9/ Congressional Budget Office, Understanding Fiscal Policy, Washington, D.C. (April 1978), Chapter III.

10/ One recent study finds that a substantial percentage of the growth of the monetary base is attributable to deficits. (Mickey D. Levy, "Factors Affecting Monetary Policy In An Era of Inflation," prepared for presentation to the 50th Annual Conference of the Southern Economic Association, Washington, D.C., November 6, 1980.) A monetarist might view such a result as one explanation why the beneficial impact of deficits on reducing the unemployment rate tends to be much shorter lived than the impact on inflation. Most studies, however, have found an insignificant correlation between deficits and money supply (see, for example, Robert Barro, "Federal Deficit Policy and the Effects of Public Debt Shocks," National Bureau of Economic Research, Working Paper No. 443 (February 1980); and William Niskanen, "Deficits, Government Spending, and Inflation: What Is the Evidence?," Journal of Monetary Economics, vol. 4, 1978, pp. 591-602).

finance the deficit is said to "crowd out" private investment. Second, deficits increase aggregate demand above the balanced budget level and thus increase income. As real income rises, people save more. Thus, deficits, by raising income and the profitability of investment, may result in a higher level of both saving and private investment. While the financing of deficits tends to crowd out private investment, but the income effect tends to "crowd in" investment.

The potential for crowding in, however, depends on the ability of the deficit to increase real income. When the economy is at high levels of employment, this potential disappears. During periods of high labor and capacity utilization, deficits are apt to crowd out and reduce productivity. During recessions, deficits are likely to crowd in.

Deficits and the Growth of the Public Sector. In a sense, deficit financing of expenditures reduces the perceived cost of government, compared to tax financing, and may thereby lead to a bias toward governmental growth. Deficit financing of larger government expenditures increases aggregate demand more than tax-financed expenditures, in part because the public, as taxpayer, perceives the cost of the larger budget as lower if taxes are not raised. Similarly, deficits may disguise the true resource cost of government spending, especially at high-employment levels, and induce the public to accept a larger budget than they would choose with full knowledge of the cost.

Few studies have attempted to quantify the magnitude of this "fiscal illusion" from deficits. One study that did attempt to do so found that, over the 30-year period 1947-1976, deficits increased the level of federal spending by about 2.8 percent. 11/

Economic Prospects Under a Balanced Budget Constraint

Using recent economic history and conventional macroeconomic models as guides, some qualitative statements can be made about the likely consequences of a balanced budget rule.

11/ William A. Niskanen, "Deficits, Government Spending, and Inflation: What is the Evidence?" Journal of Monetary Economics, vol. 4, no. 3 (August 1978), pp. 591-602.

Assuming that, in the absence of such a rule, fiscal flexibility would favor deficits over surpluses, a balanced budget rule would result in higher unemployment and lower inflation, on average. 12/ If the deficit bias persists during periods of high employment, some private investment may be crowded out, with adverse long-run effects on productivity and inflation.

Disturbances to the economy would generate business cycles of substantially greater intensity and duration with a balanced budget constraint. Conversely the potential for the budget to act as an independent source of economic instability would be reduced.

Although the foregoing constitutes CBO's "best guess" estimate of the consequences of adopting a balanced budget constraint, there is reason to believe that this estimate may be a "worst case" scenario. Two basic objections, in particular, might be raised to suggest that the disruptive effects of balanced budgets have been overstated. These involve the nature of the model used in the evaluation and the implicit assumption about the rigor of the balanced budget rule.

The CBO prognosis is based on a model of the economy which, though widely used by business and government economists, is not universally accepted as useful for policy evaluation purposes. 13/ One of the objections to this model is that it may overstate the effect of budget changes on real economic variables because it does not distinguish budget changes that can be anticipated by the public from those that cannot. The gist of this objection is that the private sector of the economy can adjust to--that is, minimize the disruptive effects of--budget changes that it can

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12/ Under the assumption that the unconstrained budget process in the future would tend toward surpluses, a balanced budget regime would raise inflation and lower unemployment.

13/ See, for example, "In Praise of the Business Cycle" (Interview with Professor Fischer Black), Fortune, October 22, 1979, pp. 155-157; Robert E. Lucas, Jr., "Econometric Policy Evaluation: A Critique," in K. Brunner and A H. Meltzer, eds., The Phillips Curve and Labor Markets, Carnegie-Rochester Conference Series on Public Policy; and R.E. Lucas, Jr. and Thomas J. Sargent, "After Keynesian Macroeconomics," Quarterly Review, Federal Reserve Bank of Minneapolis (Spring 1979).

anticipate. Assuming competitive behavior in most markets, if the public learns to anticipate various types of budget changes, such as countercyclical budget policy or cyclically unresponsive policy (as with annually balanced budgets), the effects of these vastly different fiscal regimes may be quite small.

Moreover, a balanced budget rule might not be so tightly binding as has been assumed here. First, most proposals contain override provisions. By a simple or super majority, the Congress might suspend the constraint. Several proposals discussed in Chapter IV permit unplanned deficits resulting from a decline in revenues after Congress adopts the budget. Finally, a balanced budget rule might be weakened by the increased use of regulatory and off-budget methods of achieving government objectives. Deviations such as these from the policy of rigorous balance, as outlined in Chapter VII, would reduce the effects of a balanced budget rule.

CHAPTER VI. THE EFFECTS OF EXPENDITURE LIMITATIONS ON THE ECONOMY AND THE SIZE OF THE FEDERAL SECTOR

As with the preceding discussion on the effects of annually balanced budgets, the analysis in this chapter is predicated on the successful implementation of proposals to check the growth of federal expenditures.

EFFECTS ON THE ECONOMY

In theory, limitations on expenditure growth that are not tied to a balanced budget requirement are not necessarily destabilizing, regardless of how they are designed. Appropriate degrees of fiscal restraint or stimulus could be provided through unconstrained tax changes.

The reality of fiscal policy under an expenditure limitation might be very different from abstract possibilities, however. When faced with a recession in the past, various Congressional committees reported out stimulus bills affecting programs within their jurisdictions. This created a stimulus package consisting of tax cuts and various types of expenditure increases. The mix in the package, in turn, helped to obtain enough votes for the passage of each individual bill in the package. The practical effect of a spending limitation would be to reduce the possibility of putting together a politically acceptable package. It could be argued, therefore, that expenditure limitations would, in effect, reduce the probability that the Congress would pass stimulus legislation. 1/

1/ On the other hand, if the total stimulus had to be provided through revenue reductions, the necessary coalition could also be created through the inclusion of a variety of tax rate cuts and tax expenditures benefiting different constituencies. The coalition thus created might not be as broad as one that also included spending increases, however, and the tax changes might be difficult to reverse in later periods of economic expansion.

If it is assumed that expenditure limitations would not affect the Congress' ability to enact a budget with a deficit, it follows that such limitations, in themselves, would not necessarily affect the long-term rate of inflation. One possible exception is the expenditure limitation proposed by Professor Milton Friedman and the National Tax Limitation Committee and introduced in the House as H.J. Res. 169 by Representative Jenkins and in the Senate as S. 58 2/ by Senator Heinz. This proposal seeks to offer policymakers an anti-inflation incentive by lowering its expenditure growth rate limit by one-fourth of the percentage by which inflation exceeds 3 percent. The effectiveness of such an incentive depends, of course, on the ability of federal officials to lower the inflation rate and the willingness of those officials and the public to accept the other economic consequences of the actions that would have to be taken to accomplish this task. Finally, to the extent that expenditure limitations would not affect the size of federal deficits, they would not reduce the possibility of federal borrowing and the crowding out of private sector investment during periods of high employment.

EFFECTS ON THE SIZE OF THE FEDERAL SECTOR

As indicated in Chapter IV, all expenditure limitation formulas can be modified either to limit the growth or to reduce the size of the federal sector. This section describes the budgetary consequences of S.J. Res. 58, H.J. Res. 350, and other examples of the more frequently proposed options to limit expenditure growth.

Options

Chapter IV set out four options for expenditure limitation formulas. For each of these options, at least one bill or amendment is analyzed below as representative of that type of approach.

Option I--Set a Fixed Maximum Percentage Rate of Growth for Federal Outlays. H.R. 650, a bill introduced by Representative Wylie, would limit growth of all federal outlays and new budget authority to 7 percent per year. Any bill or resolution that would cause the growth rate to exceed the limit could be considered only during a war declared by the Congress or by the passage of a concurrent resolution by a two-thirds vote of the total membership of each House.

2/ S. 58 is a statutory version of H.J. Res. 169, which is a proposed constitutional amendment.

Option II--Limit Federal Outlays to a Fixed Percentage of an Economic Indicator. Two proposals are analyzed under this option. The first, H.R. 702, introduced by Representative Brown, would limit total federal unified budget outlays in the second concurrent resolution on the budget to 21 percent of that fiscal year's GNP during the first year of implementation, 20 percent during the second year, 19 percent during the third year, and 18 percent during the fourth year. As introduced, H.R. 702 would only apply to fiscal years 1982, 1983, 1984, and 1985. In order to compare it to the other options, it is assumed that it would be implemented in fiscal year 1983 and would apply to the entire five-year period 1983-1987, with the 18 percent GNP limit on the fourth and fifth fiscal years.

A disadvantage of formulas that limit outlays to a percentage of a single year's GNP is that the limit would rise and fall with economic cycles. As illustrated below, those formulas that limit expenditures to a percentage of actual GNP (or to a growth rate of actual GNP) would require outlay reductions during a recession.

One possible way to avoid this procyclical effect would be to limit outlays to a measure of trend GNP. The second proposal under Option II, S. 1848, introduced by Senator Gorton, follows this strategy. It would limit total budget outlays in budget resolutions to a percentage of an adjusted GNP based on average growth rates over a completed five-year period. The limit would be 22 percent of this adjusted GNP during the first year of implementation, 21.5 percent during the second year, 21 percent during the third year, 20.5 percent during the fourth year, and 20 percent thereafter. 3/

3/ The adjusted GNP would be obtained by multiplying current dollar GNP for the most recently completed fiscal year by one plus a five-year average growth rate of current dollar GNP and then multiplying that result by one plus the five-year average growth rate a second time. For example, to obtain the limit for fiscal year 1983, one would multiply current dollar GNP for fiscal year 1981 (the most recently completed fiscal year since the concurrent resolutions for fiscal year 1983 would be enacted during fiscal year 1982), by one plus an average of the current dollar GNP growth rates for fiscal years 1977, 1978, 1979, 1980, and 1981. One would then multiply that result by one plus the same five-year average growth rate. Finally, the adjusted GNP figure would be multiplied by 0.22 since the limit would be 22 percent of adjusted GNP in the first year of implementation.

By using the five-year average growth rate, S. 1848 attempts to smooth the effect of economic cycles. To the extent that it succeeded, it would avoid the need to reduce federal expenditures during economic downturns.

The use of the five-year average has a second advantage--it avoids the difficulties associated with those formulas that employ estimates of economic indicators for periods that have not been completed. Thus, to produce the limit for fiscal year 1983, S. 1848 would use data from fiscal years 1977 through 1981. Although the Commerce Department is continually revising its estimates of economic performance, the use of indicators from past years would eliminate most of the reestimating problems in producing the limit. It would not, however, avoid the possibility that "optimistic" estimation techniques would be used to ensure that the upcoming fiscal year's outlays would remain under the limit. 4/

Option III--Limit the Growth Rate of Federal Outlays to the Growth Rate of an Economic Indicator. As previously stated, H.J. Res. 350 is a balanced budget amendment to the Constitution that also contains provisions to limit expenditure increases to the growth of a current dollar measure of national income--such as GNP --during the most recently completed calendar year. For example, in fiscal year 1983 total federal outlays could not increase more than the growth of GNP between calendar years 1980 and 1981. 5/

H.J. Res. 350 would limit expenditure growth by limiting the growth of total federal receipts, by requiring that planned outlays not exceed planned revenues (unless the Congress waives this provision with three-fifths votes of the entire membership of each House), and by requiring that the Congress and the President take whatever steps are necessary to ensure that actual outlays do not exceed planned outlays.

4/ S. 1848 also addresses the estimating problem by allowing estimated outlays to exceed the calculated limit by up to two-tenths of one percent of adjusted GNP before a point of order is applicable. In fiscal year 1982 this would have created a margin of error of about $6 billion.

5/ S.J. Res. 58 is not analyzed here because, as described in the previous chapter, amendments adopted on the floor of the Senate have made it a balanced budget amendment rather than one to limit spending.

H.J. Res. 350 contains a provision that would allow the Congress to raise outlays above the limit; but this could be accomplished only through the passage of a law allowing for or raising additional receipts to cover the expenditures above those in the planned budget. In this analysis, it is assumed that the Congress would not enact such a law during the next five years and thus would be forced to stay within its planned revenue-outlay limits.

As does S. 1848, H.J. Res. 350 would avoid many estimation problems by using an economic indicator from a completed year to establish the growth rate. But unlike S. 1848, H.J. Res. 350 would apply that growth rate to a revenue base for a fiscal year that would be only half over when the planned budget was developed and approved by the Congress. This could lead to some optimistic estimating by future Congresses that might overestimate current revenues in order to inflate the base used to develop the limit for the planned revenues (and thus the planned and actual outlays) for the upcoming fiscal year. Even inadvertent small errors in estimates can lead to rather large budgetary effects in future years.

Since the models that are used to forecast future GNP produce estimates within a statistical confidence interval of plus or minus 4 percent, it would not be difficult for future Congresses to shift their forecasts to the appropriate end of that interval in order to increase the estimate of planned revenues and, therefore, the outlay limit.

Option IV--One of the Above Options Plus a Provision to Reduce the Maximum Rate of Growth Unless the Federal Government Meets an Inflation Target. Under H.J. Res. 169, introduced by Representative Jenkins, total federal outlays could not increase at a greater rate than the percentage increase of actual GNP during the calendar year preceding the beginning of the fiscal year under considedration. In addition, the growth rate would be reduced by one-fourth of the amount by which the inflation rate in the preceding calendar year exceeded 3 percent.

Estimates and Assumptions

In analyzing the effects of an expenditure limitation on the size of the federal sector, two questions are of paramount importance:

- Will the expenditure limitation formula cause the public sector to remain stable, contract, or grow over long periods of time?

- If the economy shifts from a period of expansion to one of contraction, will the expenditure limitation allow for additional outlays to counteract the economic downturn, or will it require outlays reductions as the economy worsens?

To answer these questions, the effects of the five expenditure limitation proposals discussed above were analyzed under two sets of economic and budgetary conditions drawn from CBO's five-year current policy projections for the fiscal year 1983 budget cycle (see Table 10). These sets of economic and budgetary conditions are not forecasts. They were chosen to illustrate what might occur under these five expenditure limitations if the Congress adopted a budget policy assuming vigorous economic growth only to find out as the years unfolded that the actual economy performed poorly.

Optimistic Assumptions. The limitations first were analyzed under a five-year set of economic assumptions that assumes real economic growth in the 4 to 5 percent range as the economy recovered from the current recession. In this hypothetical scenario, real GNP growth would be 5.3 percent in fiscal year 1983, 5.2 percent in fiscal year 1984, 5.0 percent in fiscal year 1985, 4.6 percent in fiscal year 1986, and 4.0 percent in fiscal year 1987. The unemployment rate would decline from 7.9 percent in fiscal year 1983 to 5.6 percent in fiscal year 1987. In this strong recovery, the rate of inflation would also decline, from 6.4 percent in fiscal year 1983 to 5.2 percent in fiscal year 1987.

While these hypothetical assumptions are very optimistic, similar economic scenarios have been adopted recently by the Congress and the Administration. Under an expenditure limitation, future Congresses might be tempted to adopt such a rosy view of the future economy in order to minimize the estimate of outlays (since outlays for programs such as unemployment insurance will fall as the economy improves) and increase the estimate of revenues.

Pessimistic Assumptions. The actual world, of course, could turn out to be much less favorable than the scenario outlined above. The second hypothetical set of economic assumptions illustrates what might happen if the economy makes only a very weak recovery from the present recession. In this pessimistic scenario, real GNP growth is in the 2 to 3 percent range--2.9 percent in fiscal year 1983, 2.2 percent in fiscal year 1984, and 2.0 percent

TABLE 10. CBO'S OPTIMISTIC AND PESSIMISTIC ASSUMPTIONS (By fiscal year)

Assumptions	1982 (Estimated)	Projected 1983	1984	1985	1986	1987
Optimistic Assumption (all economic indicators by fiscal year)						
Current dollar GNP (in billions of dollars)	3,065	3,453	3,859	4,276	4,702	5,130
Current dollar GNP growth rate (annual percentage)	7.2	12.7	11.7	10.8	10.0	9.1
Constant dollar GNP growth rate (annual percentage)	-0.5	5.3	5.2	5.0	4.6	4.0
Unemployment rate (in percents, fiscal year average)	8.8	7.9	6.8	6.2	5.7	5.6
GNP deflator (in percents)	7.8	6.9	6.2	5.5	5.1	4.9
CPI (in percents)	8.2	6.4	6.2	5.9	5.4	5.2
Pessimistic Assumption (all economic indicators by fiscal year)						
Current dollar GNP (in billions of dollars)	3,062	3,399	3,739	4,088	4,454	4,837
Current dollar GNP growth rate (annual percentage)	7.1	11.0	10.0	9.3	9.0	8.6
Constant dollar GNP growth rate (annual percentage)	-0.7	2.9	2.2	2.0	2.0	2.0
Unemployment rate (in percents, fiscal year average)	8.9	8.6	8.4	8.5	8.5	8.5
GNP deflator (in percents)	7.9	7.9	7.6	7.2	6.8	6.5
CPI (in percents)	8.3	7.2	8.1	7.7	7.3	6.9

SOURCE: Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987 (February 1982).

in fiscal years 1985, 1986, and 1987. As a result of this weak recovery, unemployment remains high throughout the five-year period, declining from 8.6 percent in fiscal year 1983 to 8.5 percent in fiscal year 1987. The rate of inflation also declines more slowly than under the optimistic set of economic assumptions, with the CPI falling from 7.2 percent in fiscal year 1983 to 6.9 percent in fiscal year. 6/

Although this scenario is pessimistic, it is not beyond experience. Recent economic performance has been characterized by a series of recessions separated by weak recoveries. Any Constitutional amendment, moreover, would have to work in a variety of circumstances.

The following budgetary analysis was undertaken with the assumption that adjustments in federal revenues or forces in the nonfederal sectors of the economy resulted in the assumed levels of economic activity shown in Table 10. It could be argued that, unless revenues were adjusted or other factors caused a change in economic activity in the nonfederal sectors of the economy, the cuts below the budget projections that are required by a number of the expenditure limitation bills would prevent the achievement of the economic assumptions that underlie the projections. It is further assumed that the Congress would not exercise its option under each bill to waive the limit. In addition, it is assumed that the Congress decided to spend up to the limit in each year.

In order to compare the effects of proposals with varying implementation schedules, the following analysis assumed that the amendments were fully implemented in fiscal year 1983. In reality many of the proposals contain phasing-in provisions. For example, if passed in 1982 and ratified by state legislatures by October 1983, H.J. Res. 350 would first be effective for fiscal year 1985. In some cases, this assumption would inflate the size of the outlay reductions that the proposals would require. As explained in the previous chapter, because federal receipts will be much lower than federal expenditures, in the near term, implementing H.J. Res. 350--with its planned balanced budget requirement--would require very sharp reductions in federal outlays, equivalent in-

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6/ The association of relatively high inflation with slow economic growth is simply based on assumption to distinguish a pessimistic outlook (for both output growth and inflation) from the more optimistic alternative.

creases in federal receipts, or some combination of the two. So that the reader might better judge the impact of H.J. Res. 350, it was also analyzed under the assumption that the federal budget was balanced in fiscal year 1982 by revenues being raised to equal total federal outlays.

Several of the options, most notably S.J. Res. 58 and H.J. Res. 350, use "national income" as the economic indicator for their limitation formula, allowing the Congress to establish how national income is to be calculated. GNP was used to determine the growth rates for these formulas.

Budgetary Effects Under the Optimistic Assumptions

When the five limitation formulas are analyzed under the optimistic economic assumptions for the fiscal years 1983-1987 period, all but H.J. Res. 169 require the Congress to make reductions from the CBO current policy baseline, and all but H.J. Res. 350 and H.J. Res. 169 would require additional reductions beyond those assumed in the first concurrent resolution for fiscal year 1983. Even under these optimistic assumptions, some of the limitations would require very large reductions. 7/

Under CBO's current policy baseline, federal unified budget outlays would decline to 20.8 percent of GNP in fiscal year 1987, and total budget outlays--including off-budget outlays--would decline to 21.2 percent of GNP. In comparison, H.R. 650 would require unified budget outlays to decline to 20.2 percent. H.R. 702 would require them to fall to 18.0 percent, and S. 1848 would mandate that they drop to 20.6 percent. H.J. Res. 169, which limits total outlays, would allow them to rise to 22.9 percent in fiscal year 1987.

The effect of H.J. Res. 350, which limits total outlays, would depend on whether or not the federal budget was balanced at the time of implementation. As indicated in the previous chapter, if H.J. Res. 350 was implemented during a period of very large and persistent deficits--such as the present one--its balanced budget

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7/ As previously mentioned, any expenditure limitation formula can be adjusted so that it holds the public sector constant, allows the public sector to grow, or requires the public sector to decline.

provisions would require very large reductions in outlays unless the Congress chose to close the deficit by very large tax increases. Thus, if H.J. Res. 350 was implemented in fiscal year 1983 with its large deficit, it would require outlays to decline to 20.6 percent of GNP by fiscal year 1987. By contrast, had the budget been balanced prior to implementation of H.J. Res. 350 in fiscal year 1983, the ratio of federal outlays to GNP would be allowed to be as high as about 24 percent by fiscal year 1987, a limit well in excess of the current policy projection.

Budgetary Effects Under the Pessimistic Assumptions

All the expenditure limitation formulas that incorporate a statistical measure of the economy would require greater outlay reductions under the pessimistic set of econmic assumptions than under the optimistic scenario. For formulas that limit outlays to a percent of GNP, the additional reductions would be needed because current dollar GNP would be lower under the pessimistic assumptions than under the optimistic assumptions.

S. 1848 attempts to avoid this problem by creating a five-year average trend GNP to smooth out the effect of economic cycles. In a normal recession, such a formula would have this effect. But if a recession lasted several years or if the economy experienced a series of recessions separated by weak recoveries--as is hypothesized in the pessimistic scenario--even trend GNP formulas, such as that employed by S. 1848, would require additional reductions in outlays.

H.J. Res. 169 and H.J. Res. 350 would also follow this pattern. Both would limit future outlays by the growth rate of a completed year. The use of a lagged economic indicator would prevent these formulas from becoming more restrictive during the first two years of the fiscal year 1983-1987 period. But during the last three years of the analysis, the continuation of a weak recovery would be felt and each formula would become more restrictive than under the optimistic assumptions.

The Need to Cut Countercyclical Outlays. Under the current federal budget system outlays for certain programs automatically increase as the economy declines (countercyclical outlays). This is particularly true for unemployment compensation and some entitlement programs, such as Social Security, food stamps, and public assistance. CBO currently estimates that a one percentage point drop in the annual growth rate of real GNP will cause budget outlays to rise by $11 billion in three fiscal years. None of the

expenditure limitation formulas specifically accounts for the rising outlays caused by declining economic performance. Substituting the pessimistic economic scenario for the optimistic scenario would cause the outlays in CBO's current policy baseline to increase by $152 billion by fiscal year 1987. A similar switch of economic assumptions would cause the outlay estimates based on the first concurrent resolution for fiscal year 1983 to rise by about $80 billion. Thus the requirement of the expenditure limitation measures that spending be curbed when GNP declines must be considered in comparison to unconstrained outlays that otherwise rise during recessions. Limitation proposals would require the Congress to eliminate these countercyclical outlays, cut other programs to allow for them, or vote to waive the limitation formula during prolonged recessions or a series of recessions separated by weak recoveries.

This requirement to eliminate countercyclical outlays or make compensating reductions in other programs reflects a very different view of the relationship of the federal sector to the economy than is now held. Currently, there is general acceptance that, if the economy declines, the federal sector does not have to decline in proportion to GNP. Under current policy, federal budget outlays tend to rise as a proportion of GNP during economic downturns. The authors of S.J. Res. 58 and H.J. Res. 350 would have federal budgeting come to resemble state and local budgeting under which reductions in public services are made during recessions.

Stability of the Limits Over Time

The advocates of S.J. Res. 58 and H.J. Res. 350 point out that over the long run the formulas would hold the size of the public sector constant rather than having it grow or decline as a percentage of GNP. Logically they are correct since growth rates of current dollar measures of national income are applied to both the numerator (the limit) and the denominator (GNP in the budget year being planned) of the proportion.

Under some circumstances, however, the use of a lagged economic indicator to produce the limit could cause either a long-term decline or a long-term increase in the size of the federal sector that is allowed under the limit. For example, in a period of progressively increasing GNP growth rates--caused by progressively increasing rates of inflation, progressively increasing rates of real growth, or both--the rate of GNP growth for the budget year being planned would always be larger than the rate of

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growth that was used to develop the limit. 8/ Under these circumstances federal outlays would shrink as a percent of GNP. Of course this relationship is symmetric. During periods of long-term falling GNP growth rates the formula would allow for a federal sector that steadily grew as a percent of GNP.

As shown in Figure 9, such a long-term decline in the size of the federal sector would have occurred if S.J. Res. 58 or H.J. Res. 350 had been implemented after the balanced budget of fiscal year 1960. This figure compares the five-year moving averages of actual revenues, actual total outlays, and the outlays and revenue limits that would have been created by these resolutions. 9/ Because the rate of inflation has increased almost steadily during the last two decades, the five-year moving average of the limit declines from around 19 percent of GNP for the 1960-1964 period to just over 17 percent of GNP for the 1977-1981 period.

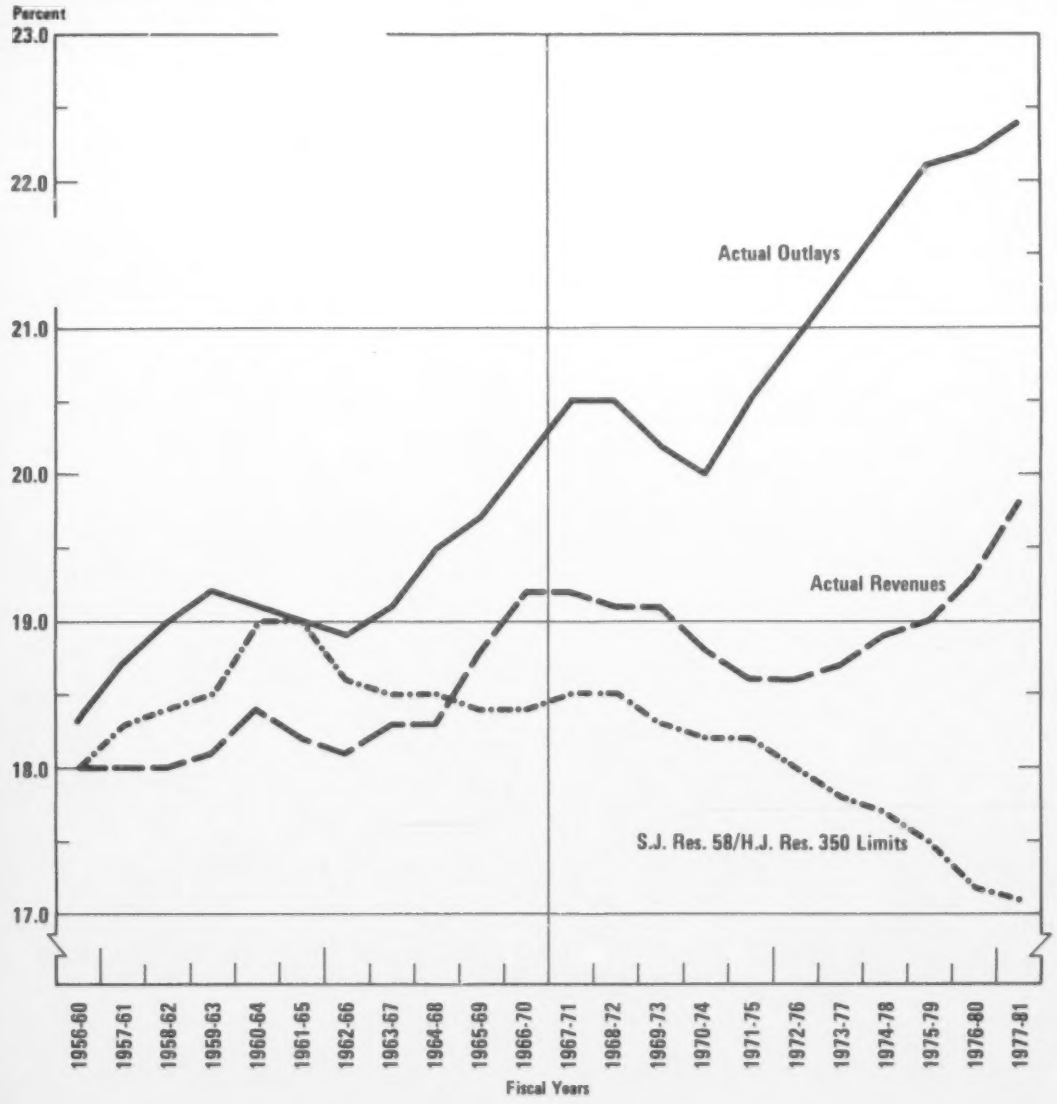
It could be argued that such a steady rise in the rate of inflation could not be sustained for more than two decades and that, when the steady rise was succeeded by the inevitable steady decline, the limit would return to its early 1960 level. Although two decades is a short time in economic history, it spans a political generation. It is an open question whether such a limit in the Constitution could be accepted by the political forces that it seeks to change or control.

8/ For example, if current dollar GNP grew at a 10 percent rate in calendar year 1983 and at a 12 percent rate in fiscal year 1985, the revenue limit (which because of the balanced budget provision sets the outlay limit), for fiscal year 1985 would allow revenues from fiscal year 1984 to 1985 to increase by 10 percent while GNP grew at 12 percent between these two fiscal years. A series of such years would lead to a gradual decline of the federal sector.

9/ The same assumptions are made here as were made for the other estimates in this chapter--namely, that the same economy would have occurred under the limit as was produced with the actual budget policy; that actual revenues would have been at the level of the limit; and that the Congress never chose to waive either the limit provision or the balanced budget prohibition.

Figure 9.

Five-Year Moving Average of Actual Outlays, Actual Revenues, and S.J. Res. 58/H.J. Res. 350 Revenue and Outlay Limits as a Percent of Fiscal Year GNP, Assuming Implementation of S.J. Res. 58/H.J. Res. 350 in Fiscal Year 1961



CHAPTER VII. DIFFICULTIES OF ENFORCING A PROHIBITION

Those who advocate statutory or Constitutional prohibitions of deficits and excessive expenditure growth seek to substitute fairly rigid rules for Congressional judgment. They do so because they believe that the traditional means of budget control cannot combat the bias that exists in representative democracies toward higher and higher expenditures financed through deficits. As such, they are trying to achieve through rules what was, in the past, achieved through belief in the intrinsic value of balanced budgets and a small public sector.

If the advocates of these proposals are correct about the bias of representative democracy, it is probable that there would be attempts to circumvent the intent of the prohibitions. The prohibitions described in this paper would undertake to change behavior patterns through statutory and constitutional rules. Some previous attempts to do so have been at least partially successful. 1/ But other efforts to change behavior through Constitutional sanctions--most notably Prohibition--not only failed but in the process created new sets of problems at least as damaging as those that led to the rule.

A central question for the Congress to address, then, is whether the proposed rules can be successfully implemented or whether they will be circumvented to such a degree that, by widening the gap between promise and performance, they will create a worse situation than exists today. This chapter discusses the difficulties of enforcement that could arise if a prohibition were enacted. 2/ It describes some of the ways that defi-

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1/ For example, the Civil War amendments guaranteeing equal rights for all citizens, although some would argue that most of the achieved success came only a century later, after passage of the Civil Rights Act of 1964. For a review of how the provisions of the U.S. Constitution have affected the substance of American economic policy, see Kenneth W. Dam, "The American Fiscal Constitution," The University of Chicago Law Review, vol. 44, no. 2, (Winter 1977), pp. 271-320.

2/ The following sections rely in part on Allen Schick, Constitutional Limitations on the Budget, Congressional Research Service, February 21, 1979. See Appendix A for greater detail.

cit prohibitions and expenditure limitations might be circumvented.

PROBLEMS OF ENFORCEMENT

Evading the Budget Process Entirely

Assuming that the prohibitions were effective in preventing deficits and checking expenditure growth, those desiring new or enlarged programs could resort to mechanisms outside the unified budget. Four such routes are regulation, government-sponsored corporations, off-budget agencies, and guaranteed loans.

Regulation. Federal regulatory activity in recent years has been expanding at least as fast as federal spending. If a budgetary prohibition was successfully implemented, it is possible that those who want a new federal program would turn to regulations to achieve their ends. If this occurred, the private and state and local government sectors would have to bear the costs. Employers, for example, could be asked to bear the total costs of national health insurance or could be required to keep former employees on the company's health plan up to six months after they were laid off. Unemployment compensation expenditures could be reduced by requiring firms to give six months' notice before laying off or firing their workers. A standard minimum pension plan could be required of all firms. The states and localities could be mandated to bear the full costs of services that are now at least partially covered by the federal government, for example, education for the handicapped. 3/

If significant activities were shifted from budgetary to regulatory status, not only would the intent of the prohibition sponsors be circumvented but the costs would be relatively hidden. To the extent that this was true, it might be even more difficult to limit the growth of regulation than is currently the case with spending.

3/ Some proposed amendments incorporate language to prevent this shifting of the burden to the states or the localities. The National Tax Limitation Committee's proposal, for example, states: "The Government of the United States shall not require, directly or indirectly, that states and local governments engage in additional or expanded activities without compensation equal to the necessary additional costs."

Government-Sponsored Corporations. Government-sponsored corporations are enterprises with completely private ownership that are chartered by the federal government to perform specialized tasks. Their financial operations are not included in unified budget totals. Today there are seven credit corporations--the Student Loan Marketing Association (SLMA), the Federal National Mortgage Association (FNMA), Bank for Cooperatives, Federal Intermediate Credit Bank, Federal Land Bank, Federal Home Loan Bank System (FHLBS), and the Federal Home Loan Mortgage Corporation (FHLMC). In fiscal year 1981 these seven corporations borrowed $33.4 billion, bringing to $161.8 billion their total outstanding debt.

Each of the corporations issues securities that are similar to the "moral obligation," or revenue bonds, issued by public authorities in many states. Although they are totally privately owned:

> Government sponsorship has provided these enterprises with certain characteristics that differentiate them in credit markets from completely private institutions. They have been given special preferences and certain tax exemptions, and their securities may be offered as investments of federally regulated institutions. These advantages give their security obligations a preferred position in the securities markets, enabling them to borrow at rates only slightly higher than those of the Treasury. 4/

Although all the current govenment-sponsored corporations perform specialized credit functions, hundreds of other corporations have been created or chartered since the first Congress. Many of these combined elements of public and private enterprise. 5/ Faced with budgetary limitations, it would not

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4/ Budget of the United States Government, Fiscal Year 1983, Special Analysis F, p. 39.

5/ "These include private corporations which are funded entirely by federal appropriations (e.g. the Legal Services Corporation), private for-profit corporations which have public and private sources of revenues (Consolidated Rail Corporation) and profit-making corporations partly owned by the federal government (National Railroad Passenger Corporation)." Allen Schick, Constitutional Limitations on the Budget, pp. 15-16.

be surprising if the Congress tried to accomplish its programmatic ends through off-budget, semi-autonomous corporations. A national health insurance plan, for example, could be run by such a corporation, as could Social Security.

Off-Budget Agencies. As indicated in Chapter IV, seven federal agencies currently are granted off-budget status by law. In fiscal year 1981 seven of these agencies--the Federal Financing Bank (FFB), the Rural Electrification and Telephone Revolving Fund, the Rural Telephone Bank, the Strategic Petroleum Reserve, the Postal Service Fund, the U.S. Railway Association, and the Synthetic Fuels Corporation--had total outlays of $21 billion. Almost all of this amount has been or will be spent by the FFB to purchase federally guaranteed loan obligations. Because these agencies do not have independent revenue sources, the public debt is increased by the amount of their outlays.

Many of the proposed prohibitions seek to limit the ability of the Congress to shift funding by the use of such terms as "total federal expenditures." In the past, however, the courts have held that budgetary terms are what the Congress says they are. 6/ Careful drafting would be necessary, therefore, to write a prohibition that would prevent a future Congress from granting more and more federal activities off-budget status.

Loan Guarantees. As discussed in Chapter IV, the fastest growing type of federal support is the loan guarantee. 7/ Between fiscal years 1967 and 1981, the total amount of outstanding guaranteed loans increased fivefold to just over $500 billion.

Traditionally, guaranteed loans were used in the housing field to help individual borrowers to become homeowners by reducing lenders' risks in making mortgages. These mortgage insurance programs continue to operate on an actuarially sound basis, charging premiums that are set high enough to cover operating costs and probable losses. Over time, guaranteed loan programs were extend-

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6/ Congressional Research Service, Constitutional Definition of Appropriations, June 4, 1979, p. 3.

7/ Guaranteed loans are contingent liabilities that require federal outlays only in case of default. They are excluded from the current budget resolutions by section 3(a) (2) of the Congressional Budget Act.

ed to marginal borrowers--students for education costs and low-income families seeking homes. Although these loans pose greater than normal risks, the government's guarantee of repayment in case of default (and, for student loans, direct subsidy of part of the interest) encourages lending institutions to make these loans at interest rates below what they would normally charge for high-risk loans. Thus, the government, in effect, provides a subsidy to the borrowers. In recent years, guarantees of very large loans have been granted to a single borrower or to a small group of borrowers running common risks--for example, New York City, the Chrysler Corporation, and synthetic fuel manufacturers. Increasingly, therefore, loan guarantees are providing large subsidies for a small number of borrowers. As such, they provide a classic target of opportunity for those wishing to circumvent statutory or constitutional restrictions on the budget.

Creating Two Budgets: The Capital Budget

Faced with limitations on the unified budget, the Congress might choose to follow the examples of private industry and many state and local governments by placing capital expenditures in a separate budget. A capital budget traditionally is a means of accounting for long-term borrowing used to finance the construction and purchase of physical assets. Such a budget strategy separates regular operating expenses from investment in physical capital assets.

Those in favor of capital budgeting contend it would foster long-range planning, standardize budget treatment of out-year costs, and provide a better tool to determine the appropriate level of debt. Most economists, however, think that the capital budget is an inappropriate tool for federal budgeting. They believe that the needs of the economy, rather than the desired level of capital investment, should govern the federal government's borrowing policy. 8/ In addition, there is some concern that, if capital outlays could be financed through borrowing while operating outlays would have to be financed through taxation, a bias would be created toward capital spending. For example, the government might help localities buy buses but not subsidize carfares.

8/ Maynard S. Comiez, A Capital Budget Statement for the U.S. Government (Washington, D.C.: The Brookings Institution, 1966).

While the federal government does not have a capital budget or issue long-term bonds for specific capital projects, the Office of Management and Budget (OMB) does tabulate those federal outlays that might be funded through a capital budget should the Congress desire to do so. It appears, however, that many of the federal outlays that are frequently classified as capital expenditures would not be so budgeted either in private industry or by state and local governments. In addition, those who espouse a capital budget overlook that outside the federal government money has to be set aside to cover repayment of the principal of the capital bonds.

According to OMB, the federal government spent $146.0 billion on investment in fiscal year 1981, with $70.4 billion allocated to physical assets and the remainder to investment in education and "human" capital development. 9/ This $146.0 billion, however, does not take into account any appropriations needed to service associated debt if these expenditures were moved in a capital budget. (Traditionally, state and local governments make yearly appropriations into a sinking fund in order to redeem capital expenditure bonds when they come due.) Thus, the actual amount of outlays that would escape unified budget coverage would equal the amount raised from long-term capital bonds minus the amount appropriated (and thus carried as additional outlays in the unified budget) to be set aside to retire the bonds eventually.

In a 1979 study conducted for the Congressional Budget Office at the request of the House and Senate Budget Committees, the consulting firm of Peat, Marwick, and Mitchell (PMM) translated the federal budget for fiscal year 1978 into the budget formats of four states: California, Illinois, Maryland, and New York, all of which use a capital budget. 10/ (A fuller description of the study's findings and methodology is set out in Appendix A.)

Following an agreed-upon rule to include in a federal capital budget only those federal outlays that were equivalent to each state's capital spending, PMM calculated that between $20.7 billion and $32.2 billion of fiscal year 1978 federal outlays would

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9/ Budget of the United States Government, Fiscal Year 1983, Special Analysis, pp. 85-101.

10/ Peat, Marwick, Mitchell and Company, A Comparative Analysis of Federal and Selected State Financial Data (study prepared for the Congressional Budget Office, April 1979).

qualify for a state-like capital budget. The major category of investment spending (as defined by OMB) excluded from their calculations was the $20.9 billion for acquisition of major military equipment. Using a typical repayment schedule, PMM estimated that, if the federal government had a capital budget and followed state practice, an amount equivalent to 30 percent of the fiscal year 1978 bondable capital outlays would have to be appropriated (on budget) for placement in a bond repayment fund. 11/ Following the practice of these four states, therefore, PMM estimated that the existence of a federal capital budget would have shifted from $14.5 to $22.5 billion from the unified to the capital budget, thus escaping the expenditure limit and lowering the deficit (see Table 11).

TABLE 11. REDUCTION IN UNIFIED BUDGET RESULTING FROM HYPOTHETICAL FISCAL YEAR 1978 FEDERAL CAPITAL BUDGET FOLLOWING THE BUDGETARY PROCEDURES OF FOUR STATES (In billions of dollars)

	California	Illinois	Maryland	New York
Estimated Bondable Capital Outlays by State Definitions (reduction of federal budget outlays)	-27.6	-32.2	-27.5	-20.7
Estimated Associated Debt Service Principal Repayment (additions to federal budget outlays)	+ 8.2	+ 9.7	+ 8.2	+ 6.2
Net Adjustment (total reduction of federal budget outlays)	-19.4	-22.5	-19.3	-14.5

11/ It should be noted that under current federal practice an appropriation to a bond repayment fund would not be counted as an outlay.

It is possible, of course, that a Congress seeking to avoid a budgetary restriction would include the entire $70.4 billion spent on physical capital investment in fiscal year 1981 in its capital budget and continue the current federal policy of not appropriating funds for repayment of debt principal. In such a case, total expenditures and the deficits or surpluses would be adjusted by this full amount.

AVOIDING AN EXPENDITURE LIMITATION

The previously discussed strategies could be used to avoid either a balanced budget rule or an expenditure limitation. There are two additional ways of initiating or enlarging federal programs while complying with a limitation on spending growth: increasing the use of accounting practices that minimize total outlays and expanding the use of tax expenditures.

Manipulating the Definition of Outlays

Outlays are generally thought to occur whenever the federal government pays out funds. While what constitutes an outlay is not in question, the use of various accounting techniques could be expanded to minimize outlays for budget purposes. Some of these techniques could significantly lower the total of outlays carried in the budget.

Receipts as Negative Expenditures. There are a number of receipts that, for federal budget purposes, are treated as negative outlays (that is, subtractions from outlays) rather than revenues. These offsetting receipts arise from intergovernmental transactions (mostly involving payments to and from trust funds) and from the sale of government assets such as the leasing of rights to search for oil on the Outer Continental Shelf. While there are legitimate economic reasons for this accounting practice, it is also true that, if they had been counted as revenues rather than as negative outlays, total unified budget outlays in fiscal year 1981 would have been $104.3 billion, or 15.9 percent, higher.

Counting receipts as negative expenditures could also be used to manipulate outlay totals at the estimation and execution stages of budgeting. In the past, for example, administrations have submitted unrealistic estimates of expected receipts from Outer Continental Shelf oil leases and royalties. Because leases are granted through a bidding process, budget planners could lower

their estimates for total outlays and the deficit by anticipating very successful auctions. When these failed to occur, actual outlays would be several billion dollars higher than anticipated.

Offsetting receipts also occur when the federal government sells loan assets. When the government issues securities known as certificates of beneficial ownership (CBOs), the transaction is viewed as an exchange of assets. By increasing the volume of CBOs sold in any given year, the Executive Branch could reduce the level of expenditures by increasing the level of negative outlays.

Expanded Use of Tax Expenditures

Tax expenditures--revenue losses resulting from provisions in the tax code that provide preferential tax treatment for certain groups of taxpayers--have been increasing at a faster rate than outlays in recent years. Since fiscal year 1975, they have risen by 121.5 percent to an estimated $228.6 billion in fiscal year 1981. This represents an average annual growth rate of 16.4 percent since 1975. Outlays have grown at an average of 12.5 percent annually over the same period.

In many budget functions--such as Commerce and Housing and General Purpose Fiscal Assistance--tax expenditures are the predominant method of federal assistance. In a number of other budget functions--International Affairs; General Science, Space, and Technology; Energy; Agriculture; and Education, Training, Employment, and Social Services--they make up at least a fifth of all federal support.

The successful implementation of an expenditure limitation would probably lead to additional tax expenditures. 12/ Such an expansion would reduce the revenue burden and could further reduce the fairness of the tax system in that individuals with the same amount of income and from the same types of families would be paying different amounts of taxes.

As indicated in Chapter V, H.R. 6021, introduced by Representative Giaimo in the 96th Congress, attempted to close this potential loophole by applying a limiting formula to the sum of

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12/ Of course, the expanded use of tax expenditures could not be used to avoid a balanced budget amendment.

outlays and tax expenditures. Other alternatives would be to include tax expenditures in the budget resolutions or to require that any sunset provisions that are adopted by the Congress must apply to tax expenditures as well as to outlay programs. 13/

LOSS OF CONGRESSIONAL AUTHORITY

The adoption and implementation of a balanced budget rule or an expenditure limitation would result in loss of Congressional authority in two ways. First, these proposals, by their very nature, seek to reduce Congressional flexibility in budget-making. As previously stated, many critics of the present budget process see flexibility, particularly in determining fiscal policy, as the cause of many of America's economic problems. Others see fiscal policy as a central function of government, whatever are the imperfections in implementing it.

Second, a sringent budget rule would, in all probability, shift the responsibility for economic policy from the Congress to the Federal Reserve, the courts, and/or the President, or all three. As discussed in Chapter V, under a balanced budget rule, fiscal policy would largely be removed as a tool of discretionary economic policy, with increasing reliance placed on monetary policy. As such, Congressional authority over economic policy would decline while that of the Federal Reserve would increase. Under these circumstances, the Congress might choose to exert greater control over the Federal Reserve.

The courts would gain budgetary power because they might be asked eventually to enforce the prohibition against a possibly reluctant Congress. Several proposals, for example, include provisions stating who can sue whom in what court to enforce the proposed act.

A shift of authority from the Congress to the President would be a possible alternative to court enforcement. Several states require that their Governor ensure that expenditures do not exceed revenues. Several of the proposals before the Congress would re-

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13/ These alternatives are discussed in Congressional Budget Office, Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1981-1985 (April 1980), pp. 9-17.

quire that the President impose a surtax if it appears that a deficit is likely to occur or impound funds if an expenditure limitation is exceeded. Even in proposals requiring super majorities for enforcement, the President would have the option of vetoing the legislation.

Finally, to the extent that a prohibition was effective in preventing deficits or limiting expenditures, responsibility for many public programs would likely shift from the federal to the state and local sectors. State and local governments--with their greater reliance on hidden taxation--have been able in the past to increase the revenue burden to cover additional expenses. If the bias toward a larger public sector still existed after the enactment of a federal prohibition, it might, therefore, cause states and localities to pick up the slack. Many of the proponents of the limitations, however, would probably prefer growth at the state and local level if growth has to occur.

APPENDIX A.

APPENDIX A. LESSONS FROM STATE EXPERIENCE

Many American state governments operate under deficit and/or debt prohibitions or limitations. This appendix discusses the evidence about the effectiveness of the state statutory and constitutional limitations. On the plus side, state governments do appear to balance their operating budgets. In a study conducted for the Congressional Budget Office, the consulting firm of Peat, Marwick, Mitchell and Company (PMM) recast the 1978 year-end financial status of four states--California, Illinois, Maryland, and New York--in the budget format used by the federal government; conversely, the study recast the federal government's financial statements for fiscal year 1978 into the budget formats of the four states. The state surplus and the federal deficit remain regardless of budget presentation. Thus, it does not appear that the surpluses of these four states are the artificial creations of accounting differences.

On the negative side, state debt has been increasing at a more rapid rate than federal debt over the past 20 years. Moreover, states faced with statutory and constitutional limitations on debt appear to have avoided the limitations successfully by creating various authorities that are allowed to issue "moral obligation" bonds. This appendix includes an essay by Allen Schick of the Congressional Research Service that sets out the negative evidence on the state record.

POSITIVE EVIDENCE

All but two states--Connecticut and Vermont--are governed by either a constitutional or legislative limitation on operating budget deficits (see Table A-1). These limitations take various forms: limit the amount or type of debt a state may incur (25 states); require that appropriations do not exceed estimated revenues (20 states); require that the Governor submit a balanced budget (18 states); require that expenditures be reduced if a short-fall appears imminent (19 states); require that a tax be levied the following year to pay off any debt (4 states). In addition, 18 states limit nonoperating budget debt; four require a referendum to incur debt, seven have a flexible limit that is tied to revenue collections or property values, five have a dollar

TABLE A-1. SUMMARY OF LIMITATIONS ON STATE DEFICITS

Type of Provision	Number of States With Deficit Limitations That Are: Prohibitive	Constraining Only	Total
Constitutional	33	6	39
Statutory Only	6	3	9
None	--	--	2
Total	39	9	50

SOURCE: National Association of State Budget Officers, Limitations on State Deficits (Lexington, Kentucky: Council of State Governments, 1976).

limit that can only be exceeded by a referendum, and two require an extraordinary majority of three-fifths to three-fourths of the legislature to incur debt.

Have these requirements prevented the states from running persistent and large deficits? The answer appears to be both yes and no.

On the affirmative side, most of the states run surpluses most of the time--especially in their operating budgets. Even when the various budgets that make up a state's total financial picture are grouped together as if they were part of a unified budget, states either run a surplus or a very small deficit. In the Peat, Marwick, Mitchell and Company study, the budgets of California, Illinois, Maryland, and New York were recast into a unified budget following the federal budget format. As can be seen in Table A-2, the surplus/deficit picture is improved in three out of the four states. This occurs because the surpluses in the state retirement system trust funds are so large that they

TABLE A-2. CONVERTING SAMPLE STATE BUDGETS TO THE FEDERAL FORMAT: SUMMARY OF ADJUSTMENTS (In millions of fiscal year 1978 dollars)

Adjustment or Step	California	Illinois	Maryland	New York
Published Financial Results	5,346	-156	153	4
Elimination of Prior Year Deficit (+) or Surplus (-)	-3,389	163	-64	0
Annual Surplus or Deficit, Adjusted	1,957	7	89	4
Addition of Net Appropriated Funds Not Included in General Fund	1,181	71	33	175
Addition of Net Off-Budget Activities Comparable to On-Budget Federal Activities	--	22	60	-206
Elimination of Net Bond Proceeds and Debt Repayments	-106	-218	-606	-103
Addition of Retirement Funds, Net	1,997	480	276	1,734
Other Adjustments, Net	--	--	-118	301
Revised Surplus or Deficit	5,029	362	-266	1,905

SOURCE: Peat, Marwick, Mitchell, and Company, A Comparative Analysis of Federal and Selected State Financial Data, Exhibit II-1, p.13.

counteract the negative effect of bringing off-budget agencies and capital budget borrowing onto the unified budget. 1/

State and local limitations on capital borrowing have helped control total debt accumulation. Between 1970 and 1975, for example, the state and local bond issue elections required by many of the limitations gave voters the opportunity to reject 48.7 percent of the indebtedness requested by the various state and local legislatures.

On the other hand, it is also true that state and local debt has been accumulating at a faster rate than federal debt since World War II. In recent years, moreover, states have established special authorities (for toll roads, college dormitories, housing, office buildings, etc.) that are empowered to issue bonds to finance construction. These revenue bonds are not backed by the full faith and credit of the state; rather, they are considered moral obligation bonds.

These authorities not only allow the states to circumvent their statutory and Constitutional restraints on debt accumulation, but they also hide many state expenditures from the public scrutiny that would exist if they were included in the operating or capital budgets. These authorities are examples of the off-budget techniques that can be adopted to avoid an expenditures limitation.

1/ It should be noted that most states restrict the use of these trust fund surpluses. Thus their existence cannot be used, in itself, to determine the financial health of a state government.

NEGATIVE EVIDENCE: THE EFFECT OF CONSTITUTIONAL RESTRICTIONS ON STATE DEBT 2/

During the first months of the 96th Congress, numerous constitutional amendments have been introduced to require a balanced federal budget. While the various proposals differ in wording and detail, their common objective is to prohibit (or restrict) deficit spending by the Federal Government. Total federal expenditures would be limited to available revenues, thereby obviating the need for new long-term debt. The proposed amendments are thus similar in purpose to provisions in state constitutional limitation as evidence that American governments can be prevented from incurring debt by these kinds of limitations.

This brief report presents data on the indebtedness of state governments. Only long-term debt is included inasmuch as short-term indebtedness (less than one year's duration) might be permitted even if deficit spending were banned.

Although the constitutions of more than three-quarters of the states prohibit or restrict long-term indebtedness, the plain fact is that every state has incurred such debt. Table A-3 shows the amount of long-term debt outstanding in each state as of June 30, 1977. The debt is divided into two categories: (1) general obligations for which the "full faith and credit" of the state is pledged; and (2) nonguaranteed debt, the payment of which usually is derived from specific revenues. The finding that no state has been completely stopped from borrowing by constitutional limitations has been noted by a number of scholars. In his compendious 1941 study of state debts, B.U. Ratchford commented that:

> after a [constitutional] limitation has been imposed there are usually many attempts to evade or circumvent it. As the conditions which prompted the limitation recede into the background, there is frequently a tendency for these efforts to increase while the defense of the limitation weakens. 3/

2/ An essay by Allen Schick, Congressional Research Service.

3/ B.U. Ratchford, American State Debts (Duke University Press, 1971), p. 7.

TABLE A-3. LONG-TERM INDEBTEDNESS OF STATE GOVERNMENTS, JUNE 30, 1977 (In millions of dollars)

State	Full Faith	Non-guaranteed	Total	Percent Nonguaranteed
Alabama	111.9	885.3	997.1	88.8
Alaska	530.0	358.3	888.3	40.3
Arizona	-	101.1	101.1	100.0
Arkansas	-	140.4	140.4	100.0
California	5,704.0	1,001.0	6,710.0	14.9
Colorado	-	197.3	197.3	100.0
Connecticut	2,407.6	764.0	3,171.6	24.1
Delaware	408.7	332.9	741.7	44.8
Florida	433.7	1,569.7	2,003.4	78.3
Georgia	368.8	899.7	1,268.5	70.9
Hawaii	1,165.5	302.7	1,468.2	20.6
Idaho	1.1	49.8	50.9	97.8
Illinois	1,632.0	2,252.4	3,884.4	58.0
Indiana	-	577.6	577.6	100.0
Iowa	-	124.0	124.0	100.0
Kansas	-	402.8	402.8	100.0
Kentucky	331.3	1,709.9	2,040.6	83.8
Louisiana	1,298.2	466.0	1,764.2	26.4
Maine	274.9	289.2	564.1	51.2
Maryland	2,066.7	984.4	3,051.1	32.3
Massachusetts	3,203.4	1,345.2	4,548.6	29.6
Michigan	739.5	1,150.7	1,890.2	60.8
Minnesota	746.3	450.1	1,196.4	37.6
Mississippi	725.6	84.1	802.6	10.5
Missouri	79.1	361.4	440.4	82.0

(continued)

TABLE A-3 (continued)

State	Full Faith	Non Guaranteed	Total	Percent Nonguaranteed
Montana	7.4	94.0	101.4	93.1
Nebraska	-	59.3	59.3	100.0
Nevada	36.3	18.3	54.6	33.3
New Hampshire	223.9	118.3	363.2	32.5
New Jersey	1,680.9	2,274.8	3,955.7	57.9
New Mexico	25.0	186.9	211.9	88.2
New York	3,715.7	14,978.9	18,694.6	80.1
North Carolina	633.0	174.0	807.0	21.6
North Dakota	15.1	52.2	67.3	77.6
Ohio	1,991.1	1,079.2	3,070.3	35.1
Oklahoma	174.2	762.8	973.0	79.6
Oregon	2,412.2	19.1	2,431.2	0.8
Pennsylvania	3,848.2	2,376.7	6,224.9	38.2
Rhode Island	273.9	364.4	638.3	57.1
South Carolina	502.7	781.1	1,283.9	60.9
South Dakota	-	218.4	218.4	100.0
Tennessee	691.8	404.6	1,096.4	36.9
Texas	885.9	1,239.1	2,125.0	58.3
Utah	85.0	60.5	145.5	41.4
Vermont	252.9	201.4	454.3	44.3
Virginia	41.0	715.8	756.8	94.6
Washington	1,119.2	292.6	1,411.8	20.7
West Virginia	858.4	456.8	1,315.2	34.7
Wisconsin	1,210.7	464.0	1,674.7	27.7
Wyoming	-	73.3	73.3	100.0

SOURCE: Bureau of the Census.

Heins came to a similar conclusion in 1963, noting that

> when constitutional restrictions stood in the way of borrowing for public purposes, state legislatures improvised methods of borrowing which were, hopefully, beyond constitutional bans. When courts, in the face of taxpayer suits, ruled debt proposals to be unconstitutional, state legislatures altered their proposals until they achieved the sanction of the courts. 4/

Constitutional restrictions have not stopped the issuance of debt because states subject to the limitations have developed financing procedures which circumvent the restrictions. One form of circumvention is to earmark state revenues to service the debt; another is to provide that the debt is to be secured by certain revenues but not by the full faith and credit of the state. After some resistance in the 19th century and early decades of the 20th century, state courts generally have adhered to the "special fund doctrine" under which revenue bonds are not deemed to be obligations of the state, and hence are not subject to constitutional limitations. In a leading case, the supreme court of South Carolina upheld a scheme in which the State issued "certificates of indebtedness" to be paid from the proceeds of the gasoline tax but with an additional guarantee of the full faith, credit, and taxing power of the state. In upholding this obviously circumventious arrangement, the South Carolina court reasoned that "this pledge of the faith, credit, and taxing power of the state is merely a pledge of honor, because the State cannot be sued for an enforcement thereof without its consent." 5/

Once this breach in the constitutional provision was sanctioned, South Carolina embarked on widespread earmarking of revenues for debt service to the extent that its constitutional "debt limitation has been completely nullified by court interpretation and legislative action." 6/ Thus, half a dozen years after the landmark decision sanctioning special funds, the South Carolina Supreme Court declared: "This court has also held that bonds issued by the State which are payable out of special funds do not

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4/ A. James Heins, Constitutional Restrictions Against State Debt (The University of Wisconsin Press, 1963), p.13.

5/ State v. Moorer, 152 S.C. 527 (1929).

6/ Ratchford, op. cit., p.454.

create debts of the State . . . although the full faith, credit, and taxing powers of the State . . . are pledged for payment of the same." 7/

Nonguaranteed bonds have proliferated as a means of evading state constitutional controls. In 1949, this special form of debt was only 15 percent of the total long-term indebtedness of state governments; at the present time, more than half of the outstanding debt of state governments lacks a full faith and credit guarantee. In fact, nonguaranteed debt exceeds full faith and credit obligations in 28 states, as the data in Table A-3 show. Nine states (such as Indiana, South Dakota, and Wyoming) rely on nonguaranteed debt.

There is a definite correlation between constitutional restrictions and recourse to revenue bonds and other forms of nonguaranteed debt. In states where the legislature is unfettered by constitutional restraints on borrowing, nonguaranteed debt amounts to less than one-third of total indebtedness; in states subject to constitutional limitations two-thirds of the debt is of the nonguaranteed variety. 8/

Because states have been able to evade constitutional controls by means of nonguaranteed debt, one analyst concludes that "governmental units with relatively restrictive debt limitations have issued just as much debt as less restricted or unrestricted units. Debt limitations have merely changed the composition and increased the cost of financing capital expenditure." 9/

The issuance of nonguaranteed debt represents much more than a shift in the form of indebtedness. Nonguaranteed obligations usually carry a lower credit rating than full faith and credit obligations, and therefore bear higher interest charges. Although they are not deemed by courts to be state debt, nonguaranteed

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7/ Clarke v. South Carolina Public Service Authority, 177 S.C. 427 (1935).

8/ The classification of state constitutional restrictions is derived from Heins, op. cit., Chapter 3.

9/ William E. Mitchell, "The Effectiveness of Debt Limits on State and Local Government Borrowing" (New York University, Graduate School of Business Administration Bulletin, October 1967), p. 48.

bonds often are considered "moral obligations" of the state, and there is an expectation that the state will act to prevent default.

The issuance of nonguaranteed debt is associated with another method for evading state constitutional restrictions. Many states establish special corporations with authority to issue their own--usually nonguaranteed--debt. A state-by-state listing of the number of agencies and corporations authorized to issue debt is provided in Table A-4. The more stringent the constitutional restriction against borrowing, the greater the number of agencies or corporations authorized to borrow.

The proliferation of public corporations and "quasi" governmental units with authority to borrow has made it difficult to secure accurate and comprehensive data on the amount of state debt. The statistics in Table A-3 are derived from U.S. Census reports but they differ in many instances from the listing furnished by Moody's. Where there is a discrepancy between these two sources, Moody's--which lists every outstanding bond issue--usually shows a higher level of total debt. As might be expected, the discrepancy usually occurs in the amount of nonguaranteed debt, for it is precisely this type of obligation which is issued by special corporations. Thus, in 1977, the Census reported $450 million in nonguaranteed debt for the State of Minnesota, whereas the individual issues listed in Moody's totaled $665 million.

Although most states are restricted in their borrowing practices, total state debt has been rising more steeply than that of the Federal Government which is not encumbered by constitutional restrictions.

Table A-5 shows that the states now account for a larger share of total public debt in the United States than at any other time since World War II.

Conclusion

State experience offers meager support for the expectation that constitutional restrictions will constrain governmental borrowing. While one ought to be wary about generalizing from state to federal budgeting, the budgetary practices of the Federal Government offer little encouragement for the long-term effectiveness of constitutional limitations. Even in the absence of such limitations, the Federal Government has authorized tens of billions of borrowing by "quasi" or "non-governmental" agencies outside the statutory debt limitation currently in effect.

TABLE A-4. STATE AGENCIES AUTHORIZED TO ISSUE NONGUARANTEED OBLIGATIONS

State	Number of Agencies	State	Number of Agencies
Alabama	27	Montana	2
Alaska	5	Nebraska	4
Arizona	5	Nevada	1
Arkansas	9	New Hampshire	3
California	8	New Jersey	14
Colorado	4	New Mexico	2
Connecticut	6	New York	20
Delaware	5	North Carolina	13
Florida	10	North Dakota	9
Georgia	11	Ohio	16
Hawaii	3	Oklahoma	7
Idaho	3	Oregon	0
Illinois	13	Pennsylvania	10
Indiana	8	Rhode Island	11
Iowa	3	South Carolina	1
Kansas	9	South Dakota	6
Kentucky	7	Tennessee	4
Louisiana	19	Texas	12
Maine	5	Utah	2
Maryland	4	Vermont	6
Massachusetts	15	Virginia	7
Michigan	6	Washington	5
Minnesota	6	West Virginia	6
Mississippi	2	Wisconsin	5
Missouri	5	Wyoming	1

SOURCE: Moody's.

TABLE A-5. PERCENTAGE DISTRIBUTION, GROSS PUBLIC DEBT

Year	Federal	State	Local
1940	67.9	5.7	26.4
1950	91.4	1.9	6.7
1955	86.1	3.5	10.4
1960	80.4	5.2	14.4
1965	76.1	6.5	17.4
1970	72.1	8.2	19.7
1975	70.7	9.6	19.8

SOURCE: Tax Foundation.

The way in which constitutional provisions can be affected by "creative budgeting" is amply demonstrated by reference to the constitutional prohibition that "no money shall be drawn from the Treasury but in consequence of appropriations made by law." Despite this provision which has remained unchanged since 1787, hundreds of billions of dollars have been spent without prior appropriation. Agencies have been authorized by Congress to "borrow" from the Treasury--or the public--without first obtaining an appropriation. This technique seems to satisfy the letter of the constitutional requirement, even though the intent has not been fully honored. Other creative techniques are likely to issue from federal budgeters and legislators if they are confronted with restraints on borrowing similar to those which have been evaded by state governments.